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Case No. 12946-VCS

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

ZOHAR II 2005-1, LIMITED and ZOHAR III, LIMITED, Plaintiffs, v. FSAR HOLDINGS, INC., GLENOIT UNIVERSAL LTD., UI ACQUISITION HOLDING CO., LYNN TILTON and MICHAEL RICCIARELLI, Defendants.	:	**C.A. No. 12946-VCS**
LYNN TILTON, Counterclaim and Third-Party Plaintiff, v. ZOHAR II 2005-1, LIMITED and ZOHAR III, LIMITED, Counterclaim Defendants, -and- ALVAREZ & MARSAL ZOHAR MANAGEMENT, LLC and MBIA INSURANCE CORPORATION, Third-Party Defendants.	:	

MEMORANDUM OPINION

Date Submitted: October 27, 2017
Date Decided: November 30, 2017

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SLIGHTS, Vice Chancellor

The words parties use to bind themselves together in a contractual relationship matter. This is especially so when sophisticated parties have engaged in extensive negotiations that produce a bespoke contract. And it is so even when one of those parties later swears that all involved in the relationship intended the contract to say something other than what is captured in its clear and unambiguous terms. This is black letter contract law—both in Delaware and in New York (the law that governs the contracts at issue in this case). Yet even the most vivid legal doctrine can, at times, be obscured by complex facts and impassioned pleas to the court's sense of fairness in the midst of a potentially harsh result. That dynamic is very much at work in this case. Nevertheless, New York's contract law, like Delaware's, is not prone to outcome-driven variability. With this in mind, the result of this otherwise complicated case was cast the moment the ink was dry on the parties' contracts.

Lynn Tilton designed a unique model for investing in distressed loans through collateralized loan obligations ("CLOs")—notes issued by a special purpose entity ("SPE") and secured by a pool of loan receivables acquired by the SPE with proceeds from the note issuance. In Tilton's model, the SPE's notes would be secured by a pool of distressed loan receivables, acquired at a discount, along with substantial accompanying equity stakes in the loan obligors. The model contemplated that a Tilton-controlled entity would select the loan receivables to be acquired by the SPE and manage both the collateral and the loan obligors themselves. The SPE's

substantial equity holdings in the obligor companies allowed Tilton, through her "collateral manager" entities, to install herself as a director of those companies and to control the composition of their directorship and management more generally. As a director—or, otherwise, as ultimate controller—Tilton then sought to turn around the obligor companies, such that they could repay their loan obligations in full and on time. Successful turnaround efforts inured to the benefit of the SPE's noteholders and Tilton herself; if the collateral loan receivables "overperformed," all the SPE's notes could be (and would be) paid in full and on time, and any upside would go to Tilton (who indirectly owned all of the SPE's preferred equity). Tilton's first ventures utilizing this model, Ark I and Ark II (the "Ark funds"),[1] were by all measures very successful.

Following the success of the Ark funds, Tilton worked with several constituencies to create new CLO investment vehicles utilizing the core elements of the Ark funds. These new CLO vehicles, known as Zohar I, Zohar II and Zohar III,[2] each acquired distressed loan receivables and equity in a new portfolio of

[1] The formal names of these entities are Ark CLO 2000-1, Ltd. and Ark II CLO 2001-1, Ltd., respectively. Pre-Trial Stipulation and Order ("PTO") ¶¶ 14, 42; JX 1058 (organizational chart).

[2] The formal names of these entities are Zohar CDO 2003-1, Ltd., Zohar II 2005-1, Ltd. and Zohar III, Ltd., respectively. PTO ¶¶ 1–2; JX 1058 (organizational chart). The Court has included its own simplified version of the organizational chart submitted by the parties as an Appendix to this Opinion. The reader may find this chart particularly useful when attempting to discern the complex network of entities that comprise Tilton's organization.

companies.[3] Tilton managed the assets in the Zohar funds as "collateral manager" through separate entities she controlled. She also served in management and on the board of directors of several of the portfolio companies, including the three companies at issue in this litigation: FSAR Holdings, Inc. ("FSAR"), Glenoit Universal Ltd. ("Glenoit") and UI Acquisition Holding Co. ("UI") (collectively, the "Portfolio Companies").[4]

As with the Ark funds, the plan for the Zohar funds was that Tilton and her team would work to turn the portfolio companies around. It was projected that these efforts would enable a sufficient number of the portfolio companies to repay their loans, such that the sale of the Zohar funds' remaining assets (including portfolio company equity) would generate sufficient cash proceeds to pay their respective noteholders in full. Once noteholders and other deal participants received what was promised to them through a detailed distribution waterfall, Tilton (through other entities she controls) stood to earn a substantial return on the back-end as the Zohar funds' "preference shareholder."[5]

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[3] *See Zohar CDO 2003-1, LLC v. Patriarch P'rs, LLC*, 2016 WL 6248461, at *1–3 (Del. Ch. Oct. 26, 2016) ("*Zohar I*") (describing the Zohar CLO investment strategy), *aff'd*, 165 A.3d 288 (Del. 2017) (TABLE).

[4] PTO ¶¶ 3–5, 20, 27, 36.

[5] *See, e.g.*, Transcript of Trial (Docket Index "D.I." 361–66) ("TT") 784:1–10, 940:3–7 (Tilton).

Unfortunately, the Zohar funds have not performed nearly as well as the Ark funds. After Zohar I suffered substantial losses, litigation between various stakeholders ensued in the state and federal courts of New York.[6] Soon after, the Securities and Exchange Commission ("SEC") commenced an administrative enforcement proceeding against Tilton and several of her collateral manager entities.[7] Additionally, the Zohar funds and their former collateral managers litigated a books and records dispute in this Court.[8]

As the other Zohar funds began to underperform, the various stakeholders again began to circle the wagons. For her part, sensing that she might be replaced as collateral manager, and thereby lose control over the enterprise, in September 2015, Tilton caused Zohar II and Zohar III (together the "Zohar Funds") to grant irrevocable proxies (without consideration) for shares of the Portfolio Companies' common stock (the "Proxies") to entities under her control—Patriarch Partners XIV and Ark II. She admittedly granted the Proxies to "make certain" that she would

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[6] *Patriarch P'rs XV, LLC v. U.S. Bank Nat'l Ass'n*, 1:16-cv-07128-JSR (S.D.N.Y.); *Tilton v. MBIA, Inc.*, Index No. 68880/15 (N.Y. Sup. Ct.); *see also MBIA Ins. Corp. v. Patriarch P'rs, LLC & LD Inv., LLC*, 950 F. Supp. 2d 568 (S.D.N.Y. 2013).

[7] *See IMO Tilton*, Admin. Proc. File No. 3-16462 (SEC); *Tilton v. SEC*, 824 F.3d 276, 291 (2d Cir. 2016), *cert. denied*, 137 S. Ct. 2187 (2017). An SEC administrative law judge recently dismissed this proceeding in an Initial Decision. *IMO Tilton*, S.E.C. Release No. 1182, at 1–2, 47 (Sept. 27, 2017). It is the Court's understanding that the Initial Decision is now final as the SEC did not pursue an appeal.

[8] *Zohar I*, 2016 WL 6248461.

retain control of the Zohar Funds—and their Portfolio Companies—even if her managing entities, Patriarch Partners XIV and Patriarch Partners XV, no longer served as collateral manager.[9] With the Proxies in hand, Tilton caused her Patriarch entities to resign from their collateral manager positions in March 2016.

In November 2016, the successor collateral manager, Third-Party Defendant, Alvarez & Marsal Zohar Management ("AMZM"), acting on behalf of the Zohar Funds, executed written consents that purported to remove Tilton from the boards of the Portfolio Companies and elect new directors (the "Consents"). The Portfolio Companies refused to honor the Consents—hardly surprising given that Tilton managed and controlled them.[10] This, in turn, prompted the Zohar Funds to initiate this action under Section 225 of the Delaware General Corporation Law ("DGCL"),[11] in which they seek declarations that their Consents are valid and effective and the Proxies are invalid and ineffective.

Tilton maintains that the Proxies granted to Patriarch Partners XIV and Ark II comply with the formal requirements of Section 212(e) of the DGCL[12] and that the

[9] TT 1362:2–19 (Tilton).

[10] With respect to the companies involved here, Tilton was the sole director of FSAR and UI, and she was one of four directors on the Glenoit board. PTO ¶¶ 20, 27, 36.

[11] 8 *Del. C.* § 225.

[12] 8 *Del. C.* § 212(e).

Court cannot invoke equity to invalidate them. The Consents executed by AMZM, on the other hand, are invalid, Tilton argues, because the Zohar Funds cannot and do not own equity in the Portfolio Companies and, therefore, do not possess voting rights attendant to that equity. According to Tilton, everyone involved in these deals knew that she would own the equity in the Portfolio Companies through separate entities under her control. Tilton maintains that she executed the Proxies simply to "memorialize" the deal that the parties had struck at the outset of their relationship.[13]

The Zohar Funds, in riposte, argue that the clear and unambiguous terms of the parties' various contracts tell another story. According to the Zohar Funds, these contracts make clear that the Zohar Funds not only could but would acquire and then own equity in their portfolio companies. The "common understanding" with respect to equity ownership upon which Tilton rests her defense is nowhere captured in any of the highly negotiated contracts the parties entered into to create and structure the Zohar Funds. Nor has Tilton offered any other legally cognizable basis to ignore the clear evidence that the Zohar Funds acquired the equity in the Portfolio Companies at issue here. This equity ownership, in turn, entitled the Zohar Funds to vote their shares to remove Tilton from the Companies' boards and to replace her with the Zohar Funds' designees.

[13] Def. Lynn Tilton's Verified Countercl. ("Tilton's Countercl.") ¶¶ 23–25.

For the reasons set forth below, I have determined that Tilton's Proxies are invalid; they do not comply with Section 212(e)'s irrevocability requirements because they were not "coupled" with a valid interest, and their creation constituted a breach of the Zohar Funds' governing indentures. I have also determined that the Zohar Funds are the beneficial owners of the Portfolio Companies' equity. Their Consents are valid and they effectively removed Tilton from the boards of FSAR, Glenoit and UI. The Zohar Funds' designees are the rightful directors of the Portfolio Companies.

I. FACTUAL BACKGROUND

Trial lasted six days. The Court received over 1,400 exhibits in evidence and heard testimony from nineteen witnesses (some presented live and some by deposition), including four expert witnesses. Because I have found the relevant contracts to be clear and unambiguous, this post-trial decision relies most heavily on those contracts and, when appropriate, other contemporaneous documents. To the extent I have relied upon witness testimony, I have tried first to reconcile any conflicts, but when that was not possible, I accepted the testimony I found most believable and disregarded testimony that was not believable. I have also drawn heavily from the parties' extensive pre-trial stipulation, a rare moment of collaboration in this case for which I am most grateful. The following facts were proven by a preponderance of the evidence.

A. Parties and Relevant Non-Parties[14]

The Zohar Funds are Cayman Islands exempt companies.[15] They are CLO investment vehicles[16] that Tilton created to invest in distressed financial assets.[17] The Funds each raised approximately $1 billion of investment capital through the sale of notes to investors.[18]

The Defendant Portfolio Companies, FSAR, Glenoit and UI, are Delaware corporations.[19] FSAR is a holding company; its wholly owned operating subsidiary is Performance Designed Products, LLC ("PDP").[20] PDP designs, engineers and manufactures video game accessories.[21] Glenoit is in the home goods manufacturing

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[14] Michael Ricciarelli is named as a defendant in the caption but was voluntarily dismissed from the action prior to trial. PTO ¶ 37.

[15] PTO ¶¶ 1–2.

[16] *Id.* ¶ 8. A typical CLO "is an investment vehicle created to buy a collateral pool of debt instruments, primarily commercial loans." JX 961 (Report of Mark Froeba) ¶ 23. "CLOs borrow money to buy the collateral pool by issuing securities or instruments to investors . . . typically in the form of notes . . . and preference shares." *Id.* "The collateral pool secures the notes and preference shares and generates the income the CLO will use to make payments due on them over time." *Id.*

[17] PTO ¶ 8; JX 90 (Patriarch Partners, LLC slides explaining Zohar investment strategy) at PP225_000050789–90; JX 961 (Froeba Report) ¶ 33.

[18] PTO ¶¶ 8–9, 11.

[19] *Id.* ¶¶ 3–6.

[20] *Id.* ¶ 3; TT 1728:12–15 (C. Richards). PDP was formerly known as "Electro Source, LLC." PTO ¶ 3.

[21] TT 1729:4–12 (Richards).

business; its principal wares are shower curtains and rugs.[22] UI is a holding company; it owns 100% of the stock of UI Holding Company ("UIHC") which, in turn, owns 100% of the stock of Universal Instruments Corporation ("UIC").[23] UIC is in the business of supplying circuit board assembly equipment and technologies.[24]

Defendant, Tilton, is the founder and CEO of non-party Patriarch Partners, LLC ("Patriarch").[25] She is also the principal and owner of several affiliated entities, including non-parties Patriarch Partners XIV and Patriarch Partners XV (together the "Patriarch Managers"), both of which are Delaware limited liability companies.[26]

Tilton's affiliates, non-parties Octaluna II, LLC and Octaluna III, LLC, are Delaware limited liability companies. They hold 100% of the preference shares of Zohar II and Zohar III, respectively.[27] Octaluna II is owned by non-parties

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[22] TT 235–236 (Sacks); JX 1457 (Consolidated Financial Statements of Glenoit and Subsidiaries as of Jan. 3, 2015 and Dec. 28, 2013) at 8. Glenoit is the 100% owner of "Glenoit LLC." JX 1457 at 8.

[23] TT 421:8–422:9 (O'Leary); *see also* JX 744 (Representations and Warranties of UI Officers) at 2–3; JX 791 (Consolidated Financial Statements and Independent Auditor's Report for UI and Subsidiaries, Dec. 31, 2015) at 8.

[24] TT 373:24–374:3, 422:2–4, 426:12–427:19 (O'Leary); JX 791 at 8.

[25] PTO ¶ 6.

[26] *Id.* Specifically, Tilton managed Zohar I through Patriarch Partners VIII, LLC, Zohar II through Patriarch Partners XIV, LLC and Zohar III through Patriarch Partners XV, LLC. *Id.* ¶ 6; JX 55 ("Zohar I CMA"), pmbl., §§ 2.1, 2.2.

[27] PTO ¶¶ 13–14; TT 468:7–9 (Tilton). Lynn Tilton controls and ultimately owns the Octaluna entities. JX 1058 (organizational chart); JX 54 § 8.1; JX 55 (Zohar I CMA) at PP000677 (signature page of Zohar I CMA signed by Lynn Tilton for Patriarch

Patriarch XIV, LLC and Ark CLO 2001, Ltd.[28] Octaluna III is owned by non-parties Patriarch XV, LLC, Ark II, Phoenix VIII, LLC and another pass-through entity.[29]

Third-Party Defendant, AMZM, is a Delaware limited liability company. On March 3, 2016, AMZM became the collateral manager of the Zohar Funds upon the resignation of the Patriarch Managers and continues in that role to this date.[30]

Third-Party Defendant, MBIA, insured certain of Zohar II's notes as "Credit Enhancer" and is the "Controlling Party" of Zohar II.[31] According to Tilton, MBIA caused the Zohar Funds to bring this action as part of a larger plan to seize control of and sell the Portfolio Companies (or their assets) and, eventually, to liquidate

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Partners VIII, LLC in her capacity as manager of that entity); JX 106 (LLC Agreement of Octaluna II, LLC) § 8.1; JX 186 (LLC Agreement of Patriarch Partners XIV, LLC) § 7; JX 247 (LLC Agreement of Octaluna III, LLC) § 8.1; JX 131 (LLC Agreement of Patriarch Partners XV, LLC) § 7.

[28] PTO ¶ 13.

[29] *Id.* ¶ 14. Non-parties Patriarch XIV, LLC and Patriarch XV, LLC are owned by non-party Zohar Holdings LLC, which, in turn, is 99% owned by Tilton. *Id.* ¶¶ 13–15. The remaining 1% membership interest in Zohar Holdings LLC is held by the C.J. Tilton Irrevocable Trust. *Id.* ¶ 15. Ark CLO 2001, Ltd. is owned by Patriarch, whose sole member, LD Investments LLC, is wholly owned by Tilton. *Id.* ¶ 13.

[30] PTO ¶ 7. AMZM has entered into new collateral management agreements with Zohar II and Zohar III. JX 812 (AMZM-Zohar II CMA); JX 813 (AMZM-Zohar III CMA).

[31] PTO ¶ 9; s*ee also Zohar I*, 2016 WL 6248461, at *2 ("MBIA had served as the monoline insurer [for Ark II], meaning it had insured the principal and interest due to noteholders in the case of a default by the issuer, Ark II. Monoline insurance serves not only to protect noteholders from default, but also to enhance the credit rating of the debt issue. For this reason, a monoline insurance company, such as MBIA, is frequently referred to as a 'credit enhancer' for the debt issue.").

Zohar II's assets—all to recover money that MBIA was forced to pay out as Credit Enhancer when Zohar II defaulted in January of this year.[32]

B. The Zohar Funds

Zohar II and Zohar III are governed by separate indentures: the Zohar II Indenture is dated January 12, 2005, and the Zohar III Indenture is dated April 6, 2007.[33] The Zohar Funds are also parties to collateral management agreements ("CMAs").[34] Like the Indentures, the CMAs are integral to the Zohar Funds' structure in that they specify the roles, obligations and rights of the Funds' respective collateral managers.[35]

The Zohar II and Zohar III Indentures contain substantially similar provisions. The same is true of the Zohar II and Zohar III CMAs. These similarities reflect the parties' intent that the Zohar Funds would share the same basic structure, the elements of which are as follows:

- The Zohar Funds are SPEs; they may only engage in the following activities:

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[32] MBIA was forced to pay approximately $770 million to certain noteholders as a result of Zohar II's default on January 20, 2017. TT 24:8–12 (LaPuma); Avitable Dep. 39:15–20 (Apr. 18, 2017).

[33] PTO ¶ 9, 11; JX 108 (Zohar II Indenture); JX 1042 (Zohar III Indenture).

[34] JX 114 (Patriarch XIV-Zohar II CMA); JX 246 (Patriarch XV-Zohar III CMA); JX 812 (AMZM-Zohar II CMA); JX 813 (AMZM-Zohar III CMA).

[35] PTO ¶¶ 10, 12.

- "acquiring, managing and disposing of, and investing in, Collateral Debt Obligations . . . Equity Securities and [other specified assets]";[36]

- entering into the agreements specified in their respective Indentures, and performing their obligations under those agreements;[37]

- issuing and selling notes pursuant to their respective Indentures (and the note purchase and subscription agreements specified therein);[38]

- issuing and selling preference shares pursuant to their respective charters and the subscription agreements specified in their Indentures;[39]

- with regard to each Fund's obligations under its notes and Indenture (and certain other contracts to which it is party), pledging as security for those obligations virtually all property in which the obligor Fund has or acquires an ownership interest;[40]

- "owning equity interests of [certain special purpose affiliates]";[41] *and*

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[36] JX 108 (Zohar II Indenture) § 7.12; JX 1042 (Zohar III Indenture) § 7.12. The Zohar III Indenture uses the term "Collateral Investment" in place of "Collateral Debt Obligation." *Compare* JX 1042 (Zohar III Indenture) § 1.1 (definition of "Collateral Investment"), *with* JX 108 (Zohar II Indenture) § 1.1 (definition of "Collateral Debt Obligation"). For the sake of clarity, I use the term "Collateral Debt Obligations" to refer to both "Collateral Investments" (as defined in the Zohar III Indenture) and "Collateral Debt Obligations" (as defined in the Zohar II Indenture).

[37] JX 108 (Zohar II Indenture) § 7.12; JX 1042 (Zohar III Indenture) § 7.12.

[38] JX 108 (Zohar II Indenture) § 7.12; JX 1042 (Zohar III Indenture) § 7.12.

[39] JX 108 (Zohar II Indenture) § 7.12; JX 1042 (Zohar III Indenture) § 7.12.

[40] JX 108 (Zohar II Indenture) § 7.12; JX 1042 (Zohar III Indenture) § 7.12.

[41] JX 108 (Zohar II Indenture) § 7.12; JX 1042 (Zohar III Indenture) § 7.12.

- "such other activities [as] are necessary, suitable or convenient to accomplish the foregoing or [which] are incidental thereto or connected therewith."[42]

- At their inception, the Zohar Funds (each an "Issuer") raise investment capital by issuing notes (under their respective Indentures) and preference shares.[43]

- In turn, the Issuer's collateral manager uses the proceeds from the issuance to invest in certain financial assets—"Collateral Debt Obligations" and "Equity Securities"—in accordance with the Issuer's Indenture.[44]

- These financial assets then stand as collateral for the Issuer's obligations under its notes, its Indenture, its CMA and certain other agreements to which it is party (as provided in the Indenture).[45]

- The Indenture grants (to a trustee) a lien on virtually all property owned by the Issuer (including after-acquired property) for the security and benefit of the Issuer's noteholders and certain other defined parties.[46]

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[42] JX 108 (Zohar II Indenture) § 7.12; JX 1042 (Zohar III Indenture) § 7.12.

[43] *See* PTO ¶¶ 8, 9, 11; JX 112 (Preference Share Subscription Agreements ("PSSA") for Zohar II) at PP-DEL2-IM-000023930 to 000023970; JX 231 (PSSA for Zohar III) at PP225_000024213 to 000024268.

[44] *See* JX 108 (Zohar II Indenture) §§ 7.12, 7.13, 12.1; JX 114 (Zohar II CMA) § 2.2(a)–(b); JX 1042 (Zohar III Indenture) §§ 7.12, 7.13, 12.1; JX 246 (Zohar III CMA) § 2.2(a)–(b).

[45] JX 108 (Zohar II Indenture) at Granting Clauses, § 1.1 (definition of "Collateral"); JX 1042 (Zohar III Indenture) at Granting Clauses, § 1.1 (same).

[46] JX 108 (Zohar II Indenture) at Granting Clauses; JX 1042 (Zohar III Indenture) at Granting Clauses. The indenture trustee for Zohar II and Zohar III is U.S. Bank, N.A., as successor to LaSalle Bank N.A. PTO ¶ 17.

- The indenture trustee receives payments made on account of such collateral and deposits those funds into specified accounts (as provided in the Indenture).[47]

- Pending the maturation of the Issuer's notes, the trustee makes periodic distributions of available funds according to a "waterfall" set forth in the Indenture.[48]

- Under this "waterfall," available funds generally are distributed as follows:

  - First, for the payment of certain fees and expenses, including the indenture trustee's fee and the collateral manager's fee;[49]

  - Second, for interest and principal payments due to noteholders (subject to certain priority and allocation rules);[50] *and*

  - Third, for limited distributions to the holder(s) of the Issuer's preference shares, subject to a cap.[51]

- This same "waterfall" also governs the distribution of proceeds from the remedial sale of collateral (by the trustee) following an Event of

[47] JX 108 (Zohar II Indenture) §§ 10.1–10.10; JX 1042 (Zohar III Indenture) §§ 10.1–10.8.

[48] *See* JX 108 (Zohar II Indenture) §§ 1.1 (definition of "Payment Date"), 11.1–11.2 (provisions concerning "waterfall"); JX 1042 (Zohar III Indenture) §§ 1.1, 11.1 (same).

[49] *See* JX 108 (Zohar II Indenture) §§ 11.1(a)(i)(A)–(E), 11.2(a)(ii); JX 1042 (Zohar III Indenture) § 11.1(a)(A)–(E).

[50] *See* JX 108 (Zohar II Indenture) §§ 2.6(a)–(b), 11.1(a)(i)(F), (H), 11.1(a)(ii)(A), (C), (G), (I), 13.1; JX 1042 (Zohar III Indenture) §§ 2.6(a)–(b), 11.1(a)(i)(F), (H), (M) (a)(ii)(A), (C), (F), (H), 13.1.

[51] *See* JX 108 (Zohar II Indenture) §§ 11.1(a)(i)(M), (a)(ii)(F), (J), 11.2(a)(iii)–(v); JX 1042 (Zohar III Indenture) § 11.1(a)(i)(K), (Q).

> Default under the Issuer's Indenture (*e.g.*, non-payment of the principal balance of the Issuer's notes at maturity).[52]

A key feature of the Zohar Funds is that neither Fund is subject to U.S. tax liability for the equity held in the Fund. This feature was a major point of contention during the Ark I closing, and that deal almost fell through when the credit rating agencies announced they would not rate a CLO that potentially bore U.S. tax liability.[53] In modeling the Zohar Funds after the Ark funds, the parties recognized the tax problem upfront and structured the Zohar Funds to insulate them from potential U.S. tax liability.[54] Specifically, the parties structured the Zohar Funds as disregarded entities and, "solely for federal, state and local tax purposes," the preference shareholder of each Zohar Fund is "treated as . . . owning the assets of [that Fund] directly . . . ."[55]

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[52] *See* JX 108 (Zohar II Indenture) §§ 5.1(b), 5.4(a), 5.5, 5.7, 11.1(a), 11.2(a), 13.1(a)–(b); JX 1042 (Zohar III Indenture) §§ 5.1(b), 5.4, 5.5, 5.7, 11.1(a), 13.1(a)–(c).

[53] TT 1654:15–19 (Froeba) ("Any potential for liability is what [Moody's] concern was. I mean, that's certainly, in a [CLO] deal that has the tax strategy that they need to avoid being in a U.S. trade or business, that's a major liability that would be a concern."); TT 816:18–817:2 (Tilton).

[54] JX 112 (Zohar II Arts. of Ass'n) at PP-DEL2-IM-000024032, sched. X § 1(a); JX 1040 (Zohar III Arts. of Ass'n) at PP225_000023784, sched. X § 1(a).

[55] JX 112 (Zohar II Arts. of Ass'n, sched. X § 1(a)); JX 1040 (Zohar III Arts. of Ass'n, sched. X, § 1(a)). Thus, solely for U.S. tax purposes, Octaluna II is treated as owning the assets of Zohar II directly, and Octaluna III is treated as owning the assets of Zohar III directly. JX 112 (Zohar II Arts. of Ass'n, sched. X, § 1(a)); JX 1040 (Zohar III Arts. of Ass'n, sched. X, § 1(a)). As stated, the purpose of this structure is to insulate the Zohar Funds from U.S. tax liability. TT 816:14–817:7, 817:20–819:1 (Tilton); TT 993:20–994:5 (Bowden); TT 1371:16–1372:19, 1373:3–1375:20 (Peaslee). In general, if a non-U.S.

1. Zohar II

Zohar II closed on January 12, 2005, raising approximately $1 billion in cash through the sale of its notes.[56] The notes issued by Zohar II are divided into tranches as follows:

Zohar II Tranches[57]

Designation	Principal Amount	Note Interest Rate	Note Stated Maturity
Class A-1 Notes	$250,000,000	LIBOR + Class A Applicable Margin (or CP Funding Rate)	January 20, 2017
Class A-2 Notes	$550,000,000	LIBOR + Class A Applicable Margin	January 20, 2017
Class A-3 Notes	$200,000,000	LIBOR + Class A Applicable Margin	January 20, 2017
Class B Notes	$200,000,000	LIBOR + Class A Applicable Margin	January 20, 2020

entity (such as Zohar II or Zohar III) earns income from a U.S. trade or business, the entity is subject to U.S. tax liability in respect of that income; *i.e.*, the income is taxable to the entity. TT 993:20–994:5 (Bowden); TT 1371:16–1372:19, 1373:3–1375:15 (Peaslee). Thus, insofar as a non-U.S. CLO issuer earns income from a U.S. trade or business, certain measures must be taken to avoid entity-level tax liability in respect of that income (under U.S. tax law). TT 1374:9–1375:20 (Peaslee). First, the non-U.S. issuer must be structured as a "disregarded entity" or a partnership. *Id.* Second, the non-U.S. issuer must not have any non-U.S. tax owners. *Id.* In the Zohar Funds' case, both of these measures were implemented. JX 112 (Zohar II Arts. of Ass'n, sched. X, § 1(a)); JX 1040 (Zohar III Arts. of Ass'n, sched. X, § 1(a)).

[56] PTO ¶ 9.

[57] JX 108 (Zohar II Indenture) § 2.2(b).

In addition to its issuance of notes, Zohar II also issued preference shares (in consideration of capital contributions totaling $78 million).[58]

Zohar II's obligations under its notes are secured pursuant to its Indenture.[59] As noted, the Zohar II Indenture grants (to a trustee) a lien on virtually all of Zohar II's property (including after-acquired property) for the security and benefit of its noteholders and certain other defined parties.[60]

Additionally, Zohar II's "Class A" notes are guaranteed by MBIA (as "Credit Enhancer").[61] MBIA is also Zohar II's "Controlling Party" (pursuant to the Zohar II Indenture).[62] As Controlling Party, MBIA has certain rights, including: (1) the right to remove and replace Zohar II's collateral manager if "an Event of Default under the [Zohar II Indenture] has occurred and is continuing";[63] and

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[58] PTO ¶ 13; JX 112 (PSSA for Zohar II) at PP-DEL2-IM-000023930 to 000023970; TT 468:10–12, 883:13–19 (Tilton); *see also* JX 106 (LLC Agreement of Octaluna II) at PP225_000048571 (listing "Capital Account Balances" of Octaluna II Members).

[59] JX 108 (Zohar II Indenture) at Granting Clauses; *see id.* § 1.1 (definition of "Collateral").

[60] JX 108 (Zohar II Indenture) at Granting Clauses. The Zohar II Indenture uses the term "Secured Parties" to refer (collectively) to those creditors of Zohar II whose claims are secured by the lien of the Indenture. *Id.*

[61] PTO ¶ 9; JX 108 (Zohar II Indenture), pmbl., § 1.1 (definition of "Credit Enhancement"). Zohar II's "waterfall" includes insurance premium payments to MBIA. JX 108 (Zohar II Indenture) §§ 1.1 (definition of "Credit Enhancement Premium"), 11.1(a)(i)(F). As Credit Enhancer, MBIA is one of Zohar II's "Secured Parties." *Id.* at Granting Clauses.

[62] PTO ¶ 9; JX 108 (Zohar II Indenture) § 1.1 (definition of "Controlling Party").

[63] JX 114 (Zohar II CMA) §§ 1.1 (definition of "Cause," subsection (vii)), 5.3, 5.5.

(2) upon an Event of Default under the Zohar II Indenture, the right to cause the indenture trustee to sell any and all of the property subject to the lien of the Indenture.[64]

Zohar II's Class B notes, by contrast, are not insured. Moreover, "[s]o long as any [of Zohar II's] Class A Notes [remain] [o]utstanding . . . the payment of principal of [its] Class B Notes . . . may only occur after principal of the Class A Notes has been paid in full . . . [and] is subordinated to the payment [at scheduled intervals] of the principal and interest due and payable on the Class A Notes . . . ."[65] All of Zohar II's Class B notes are held by Octaluna II.[66]

Zohar II's preference shares represent a residual equity interest in Zohar II, meaning a right to receive whatever cash (if any) Zohar II retains after all of its notes have been paid in full.[67] Under Zohar II's waterfall, preference shareholders rank last in priority of payment.[68] On each distribution date, available funds generally must be distributed first for the payment of expenses and then for the payment of

[64] JX 108 (Zohar II Indenture) §§ 5.1, 5.4(a)(ii), (iv), 5.5(a).

[65] JX 108 (Zohar II Indenture) § 2.6(b)(1); *see also id.* § 13.1(a).

[66] PTO ¶ 13.

[67] JX 108 (Zohar II Indenture) §§ 11.1(a)(i)(M), (a)(ii)(F), (J), 11.2(a)(iii)–(v), (xi); JX 110 (Zohar II Preference Share Paying Agency Agreement) § 2.6(a)–(d).

[68] JX 108 (Zohar II Indenture) §§ 11.1(a)(i)(M), (a)(ii)(F), (J), 11.2(a)(iii)–(v) (provisions relating to $60,000,000 cap), (xi).

interest and principal on the notes (by seniority).[69] Insofar as those payments do not exhaust the funds then available for distribution, the excess funds are distributed to Zohar II's preference shareholders—subject to a $60 million cap until the notes are paid in full.[70] As with Zohar II's Class B notes, all of Zohar II's preference shares are held by Octaluna II.[71]

2. Zohar III

Zohar III closed on April 6, 2007, raising approximately $1 billion in cash through the sale of its notes.[72] The notes issued by Zohar III are divided into the following tranches:

Zohar III Tranches[73]

Designation	Principal Amount	Note Interest Rate	Note Stated Maturity
Class A-1R Notes	$200,000,000	LIBOR + Class A-1R Applicable Margin	April 15, 2019
Class A-1T Notes	$150,000,000	LIBOR + Class A-1T Applicable Margin	April 15, 2019
Class A-1D Notes	$350,000,000	LIBOR + Class A-1D Applicable Margin	April 15, 2019

[69] JX 108 (Zohar II Indenture) §§ 11.1, 11.2.

[70] JX 108 (Zohar II Indenture) §§ 11.1(a)(i)(M), (a)(ii)(F), (J), 11.2(a)(iii)–(v), (xi).

[71] PTO ¶ 13.

[72] PTO ¶ 11.

[73] JX 1042 (Zohar III Indenture) § 2.2(b).

Class A-2 Notes	$200,000,000	LIBOR + Class A-2 Applicable Margin	April 15, 2019
Class A-3 Notes	$116,000,000	LIBOR + Class A-3 Applicable Margin	April 15, 2019
Class B Notes	$196,000,000	N/A	April 15, 2019

Zohar III also issued preference shares in consideration of capital contributions totaling $60 million.[74]

As with Zohar II, Zohar III's notes are secured pursuant to its Indenture.[75] The Zohar III Indenture grants (to a trustee) a lien on virtually all of Zohar III's property (including after-acquired property) for the security and benefit of its noteholders and certain other defined parties.[76] Unlike Zohar II, however, Zohar III does not have a Credit Enhancer;[77] Zohar III's notes are not insured—whether by MBIA or any other third-party insurer.[78] Nor does Zohar III have a "Controlling

[74] PTO ¶ 14; JX 231 (PSSA) at PP225_000024213 to 000024266.

[75] JX 1042 (Zohar III Indenture) at Granting Clauses; *see also id.* § 1.1 (definition of "Collateral").

[76] JX 1042 (Zohar III Indenture) at Granting Clauses.

[77] PTO ¶ 11; TT 934:10–11 (Tilton) ("[I]n Zohar III, . . . we didn't have a monoline [insurer] . . . ."); *see generally* JX 1042 (Zohar III Indenture).

[78] *See* TT 934:10–11, 968:20–970:9 (Tilton).

Party"; instead, it has a "Controlling Class" comprised of a group of its Class A noteholders.[79]

The contractual rights of Zohar III's Controlling Class generally track those of Zohar II's Controlling Party. Thus, Zohar III's Controlling Class may remove and replace Zohar III's collateral manager "upon the occurrence of any Event of Default under the [Zohar III Indenture] that consists of a default in the payment of principal of or interest on the Notes when due and payable . . . ."[80] And, upon an Event of Default under Zohar III's Indenture, the Controlling Class may cause the trustee to sell any and all of the property subject to the lien of the Indenture.[81]

As with Zohar II, Zohar III's Class B notes are subordinated to its Class A notes.[82] Indeed, the relevant subordination provisions in the Zohar III Indenture track those in the Zohar II Indenture.[83] And, as with Zohar II, all of Zohar III's Class B notes (and preference shares) are held by a Tilton entity—Octaluna III.[84] Finally, as with Zohar II, the holder of Zohar III's preference shares is entitled to

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[79] *See* PTO ¶ 11; TT 972:11–22 (Tilton).

[80] JX 246 (Zohar III CMA) §§ 1.1 (definition of "Cause," subsection (vii)), 5.3, 5.4.

[81] JX 1042 (Zohar III Indenture) §§ 5.1, 5.4(a)(ii), (iv), 5.5(a)(ii).

[82] JX 1042 (Zohar III Indenture) §§ 2.6(a)–(b), 13.1(a)–(c).

[83] *Compare* JX 108 (Zohar II Indenture) §§ 2.6(b), 13.1(a)–(b), *with* JX 1042 (Zohar III Indenture) §§ 2.6(b), 13.1(a)–(c).

[84] PTO ¶ 14.

receive whatever cash (if any) Zohar III retains after all of its notes have been paid in full.[85] In this regard, Zohar III's waterfall is analogous to Zohar II's waterfall, except that distributions to Zohar III's preference shareholder are capped at $45 million (rather than $60 million).[86]

3. The Zohar Indentures—"Collateralization" Provisions

As indicated above, Zohar II and Zohar III (each an "Issuer") raised investment capital by issuing notes pursuant to their respective Indentures. The Indentures' Granting Clauses secure (or "collateralize") each Issuer's notes (and certain of its other obligations) by granting to the indenture trustee a lien on virtually all of that Issuer's property:

> The Issuer hereby Grants to the Trustee, for the benefit and security of the Secured Parties [which includes the noteholders] a continuing security interest in, and lien on, all of its right, title and interest in, to and under, in each case, whether now owned or existing, or hereafter acquired or arising, all accounts, payment intangibles, general intangibles, letter-of-credit rights, chattel paper, electronic chattel paper, instruments, deposit accounts, investment property (each, as defined in the UCC), and any and all other property of any type or nature owned by it (other than Excluded Property) . . . .[87]

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[85] JX 1042 (Zohar III Indenture) § 11.1(a)(i)(K), (Q); JX 222 (Zohar III Preference Share Paying Agency Agreement) § 2.6(a)–(d).

[86] JX 1042 (Zohar III Indenture) § 11.1(a)(i)(K)(2)(I).

[87] JX 108 (Zohar II Indenture) at Granting Clauses; JX 1042 (Zohar III Indenture) at Granting Clauses. The Indentures exclude $1,500 in cash ("Excluded Property") from this grant. JX 108 (Zohar II Indenture) at Granting Clauses, § 1.1 (definition of "Excluded Property"); JX 1042 (Zohar III Indenture) at Granting Clauses, § 1.1 (same). The record contains no explanation of the purpose of this Excluded Property in the overall structure of

The Indentures then define the "Collateral" for each Issuer's secured obligations in sweeping terms:

> All Money, instruments, accounts, payment intangibles, general intangibles, letter-of-credit rights, chattel paper, electronic chattel paper, deposit accounts, investment property and other property and rights subject or intended to be subject to the lien of th[e] Indenture for the benefit of the Secured Parties as of any particular time pursuant to the Granting Clauses of th[e] Indenture.[88]

Thus, the Collateral for each Zohar Fund's secured obligations consists of "any and all . . . property of any type or nature" in which that Zohar Fund has or acquires an ownership interest.

The Indentures contemplate that the Zohar Funds may own "Collateral Debt Obligations"[89] and "Equity Securit[ies]."[90] An "Equity Security" (per the Zohar II

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the Zohar Funds, and the Excluded Property is not material to any of the issues litigated in this action.

[88] JX 108 (Zohar II Indenture) § 1.1 (definition of "Collateral"); JX 1042 (Zohar III Indenture) § 1.1 (same).

[89] Section 12.1(a) of the Indentures sets forth various criteria that a "Collateral Debt Obligation" must satisfy to be eligible for inclusion in the Collateral (for the Issuer's secured obligations) as a "Pledged Collateral Debt Obligation." JX 108 (Zohar II Indenture) § 12.1(a); JX 1042 (Zohar III Indenture) § 12.1(a). For instance, Section 12.1(a)(9) provides that "such Collateral Debt Obligation" must not be an "Equity Security (other than an attached Equity Kicker . . . or an Equity Workout Security)." JX 108 (Zohar II Indenture) § 12.1(a)(9); JX 1042 (Zohar III Indenture) § 12.1(a)(9). And Section 12.1(a)(41) provides that "such Collateral Debt Obligation" must have "a Moody's Rating and a Standard & Poor's Rating." JX 108 (Zohar II Indenture) § 12.1(a)(41); JX 1042 (Zohar III Indenture) § 12.1(a)(41).

[90] JX 108 (Zohar II Indenture) § 1.1 (definition of "Equity Security"); JX 1042 (Zohar III Indenture) § 1.1 (same).

Indenture) includes "(a) [a]ny Equity Kicker, (b) any Equity Workout Security . . . and (d) any other security that does not entitle the holder thereof to receive periodic payments of interest and one or more installments of principal . . . ."[91] The Zohar III Indenture defines an Equity Security similarly.[92] Although the Zohar III Indenture does not use the term Equity Workout Security as appears in the Zohar II Indenture, it incorporates the language defining that term within its definition of Equity Security.[93]

Both Indentures address the circumstances under which the Zohar Funds may (and may not) purchase Equity Securities. In general, the Zohar Funds may not purchase an "Equity Security (except for an Equity Kicker) . . . other than in connection with a workout or restructuring of an Obligor [on a Collateral Debt Obligation], its Affiliates, or the lines of business of the Obligor, or its Affiliates."[94] An "Equity Kicker" is "[a]ny Equity Security or any other security that is not eligible for purchase by the [Zohar Fund] but is received with respect to a Collateral Debt

[91] JX 108 (Zohar II Indenture) § 1.1 (definition of "Equity Security").

[92] JX 1042 (Zohar III Indenture) § 1.1 (definition of "Equity Security").

[93] JX 1042 (Zohar III Indenture) § 1.1.

[94] JX 1042 (Zohar III Indenture) § 1.1 (definition of "Equity Security"); JX 108 (Zohar II Indenture) § 1.1 (same).

Obligation or purchased as part of a 'unit' with a Collateral Debt Obligation."[95] An "Equity Workout Security" (per the Zohar II Indenture) is "[a]ny security received in exchange for or in connection with a Collateral Debt Obligation or Unrestricted Collateral Debt Obligation, which security does not entitle the holder thereof to receive periodic payments of interest and one or more installments of principal."[96]

4. The Zohar Indentures—Negative Covenants

The Zohar Indentures include a series of negative covenants that prohibit the Zohar Funds from taking certain actions. Relevant here, at Section 7.8(a)(i), both Indentures prohibit the Zohar Funds from "sell[ing], transfer[ing], exchang[ing] or otherwise dispos[ing] of, or pledg[ing], mortgag[ing], hypothecat[ing] or otherwise encumber[ing] (or permit[ting] such to occur or suffer[ing] such to exist), any part of the Collateral," except as expressly permitted by the Indentures.[97] Similarly, at Section 7.8(a)(iv)(y), both Indentures provide that the Zohar Funds shall not "permit any lien, charge, adverse claim, security interest, mortgage or other encumbrance

[95] JX 108 (Zohar II Indenture) § 1.1 (definition of "Equity Kicker"); JX 1042 (Zohar III Indenture) § 1.1 (same).

[96] JX 108 (Zohar II Indenture) § 1.1 (definition of "Equity Workout Security"). As noted, the Zohar III Indenture does not use the term "Equity Workout Security," but does use the same definitional language. JX 1042 (Zohar III Indenture) § 1.1 (definition of "Equity Security").

[97] JX 108 (Zohar II Indenture) § 7.8(a)(i); JX 1042 (Zohar III Indenture) § 7.8(a)(i).

(other than the lien of th[e] Indenture) to be created on or extend to or otherwise arise upon or burden the Collateral or any part thereof, any interest therein or the proceeds thereof (except as may be expressly permitted [t]hereby)."[98] Finally, at Section 7.12, both Indentures prohibit the Zohar Funds from engaging in "any business or activity" other than the following:

- "acquiring, managing and disposing of, and investing in, Collateral Debt Obligations . . . Equity Securities and [other specified assets]";[99]
- entering into the agreements specified in their respective Indentures, and performing their obligations under those agreements;
- issuing and selling notes pursuant to their respective Indentures (and the note purchase and subscription agreements specified therein);
- issuing and selling preference shares pursuant to their respective charters and the subscription agreements specified in their Indentures;
- "owning equity interests of [certain special purpose affiliates]";[100]
- with regard to each Zohar Fund's obligations under its notes and Indenture (and certain other contracts to which it is party), pledging as security for those obligations virtually all property in which the obligor Fund has or acquires an ownership interest; *and*

[98] JX 108 (Zohar II Indenture) § 7.8(a)(iv)(y); JX 1042 (Zohar III Indenture) § 7.8(a)(iv)(y).

[99] JX 108 (Zohar II Indenture) § 7.12; JX 1042 (Zohar III Indenture) § 7.12.

[100] JX 108 (Zohar II Indenture) § 7.12; JX 1042 (Zohar III Indenture) § 7.12.

- "such other activities [as] are necessary, suitable or convenient to accomplish the foregoing or [which] are incidental thereto or connected therewith."[101]

5. The Collateral Management Agreements—Key Provisions

As noted, the Zohar Fund's Collateral is managed by a collateral manager.[102] Section 2.2 of each CMA provides that the collateral manager will render specified services to the Zohar Funds "in accordance with the terms of the Indenture[s] and [the CMAs]."[103] Those services include the following:

- "Subject to any restrictions in the Indenture, . . . effectuat[ing] the acquisition, origination, restructuring, exchange or disposition of Collateral on behalf of the [Zohar Fund] . . .";[104]

- "Mak[ing] determinations with respect to the exercise or enforcement of any and all rights by the [Zohar Fund] including . . . voting rights and rights arising in connection with the bankruptcy or insolvency of [an obligor on a Collateral Debt Obligation] or . . . [the] restructuring of the debt or equity [of any such obligor] . . .";[105] *and*

- "[M]onitor[ing] the Collateral on an ongoing basis, [and] prepar[ing] and deliver[ing] information [and] reports [about the Collateral] . . . ."[106]

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[101] JX 108 (Zohar II Indenture) § 7.12; JX 1042 (Zohar III Indenture) § 7.12.

[102] JX 114 (Zohar II CMA) §§ 2.1, 2.2; JX 246 (Zohar III CMA) §§ 2.1, 2.2.

[103] JX 114 (Zohar II CMA) § 2.2; JX 246 (Zohar III CMA) § 2.2.

[104] JX 114 (Zohar II CMA) § 2.2(b); JX 246 (Zohar III CMA) § 2.2(b).

[105] JX 114 (Zohar II CMA) § 2.2(c); JX 246 (Zohar III CMA) § 2.2(c).

[106] JX 114 (Zohar II CMA) § 2.2(f); JX 246 (Zohar III CMA) § 2.2(f).

Section 2.6 of the CMAs prohibits the collateral manager from causing the Zohar Funds to violate the terms of the Indentures.[107] In addition, both CMAs contemplate that the collateral manager may be removed and replaced in certain circumstances (or otherwise may resign and be replaced).[108] Thus, under the Zohar II CMA, Zohar II's Controlling Party may remove and replace the collateral manager if "an Event of Default under the [Zohar II Indenture] has occurred and is continuing."[109] Similarly, under the Zohar III CMA, Zohar III's Controlling Class may remove and replace the collateral manager "upon the occurrence of any Event of Default under the [Zohar III Indenture] that consists of a default in the payment of principal of or interest on the Notes when due and payable . . . ."[110]

C. The Zohar Funds Acquire Stock in the Portfolio Companies

The Zohar Funds acquired debt and equity of the three Portfolio Companies at issue here in six separate transactions. I discuss each briefly below.

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[107] JX 114 (Zohar II CMA) § 2.6 ("Unless otherwise required by any provision of the Indenture or [the CMA] or by applicable law, the Collateral Manager shall not take any action which it knows or should be reasonably expected to know in accordance with prevailing market practices would . . . cause the [Zohar Fund] to violate the terms of the Indenture . . . ."); JX 246 (Zohar III CMA) § 2.6 (same).

[108] JX 114 (Zohar II CMA) §§ 5.3(a), 5.5; JX 246 (Zohar III CMA) §§ 5.3, 5.4.

[109] JX 114 (Zohar II CMA) §§ 1.1 (definition of "Cause," subsection (vii)), 5.3, 5.5.

[110] JX 246 (Zohar III CMA) §§ 1.1 (definition of "Cause," subsection (vii)), 5.3, 5.4.

1. Zohar II Acquires FSAR and Glenoit Debt and Equity from Ark I

At its inception, Zohar II purchased from Ark I a portfolio of loan receivables and associated equity interests in certain loan obligors (including Glenoit and FSAR) (the "Zohar II-Ark I Transfer").[111] To effect this transfer, Zohar II and Ark I entered into an "Issuer Collateral Debt Obligations Transfer Agreement" dated January 14, 2005.[112] Under that Agreement, Ark I transferred to Zohar II "any and all of [Ark I's] right, title and interest in" the following:

- a portfolio of credit receivables (Collateral Debt Obligations), including a $5,878,066.95 Glenoit obligation and a $11,210,000.00 obligation of FSAR subsidiary Electro Source, LLC (PDP's predecessor);[113] *and*

[111] JX 120 (Issuer Collateral Debt Obligations Transfer Agreement) §§ 1(o)(i)–(ix), 2, sched. 1; *id.* at Recitals; JX 108 (Zohar II Indenture), sched. A-2, note 1; JX 132 (Ark I Obligors Letter), sched. c; JX 1017 (Affidavit of Lost Certificate) at PP255_000011337, ¶¶ 2–3. For the Zohar II-Ark I Transfer, Zohar II paid Ark I consideration consisting of more than $200 million cash (raised through the sale of the notes), plus Preference Shares valued at $38,236,830. JX 120 (Issuer Agreement), Ex. A. The Zohar II Indenture disclosed to investors that Ark I owned equity interests in certain of the loan obligors (including FSAR and Glenoit), and that Ark I transferred its equity interests to Zohar II as part of the Zohar II-Ark I Transfer. *See* JX 108 (Zohar II Indenture), sched. A-2, note 1 ("Except for those borrowers noted with an asterisk, Ark I owns equity interests in each such borrower, which equity interests (other than those of borrowers B10 and B23 above) are also being transferred to [Zohar II]."). Ark I referred to borrowers as "B[#]" because it wished to keep their identities confidential. Glenoit is B12 and FSAR is B6. JX 108 (Zohar II Indenture), sched. A-2; JX 120 (Issuer Agreement), sched. 1.

[112] JX 120 (Issuer Agreement).

[113] JX 120 (Issuer Agreement) §§ 1(o), 2, sched. 1.

- with respect to each Collateral Debt Obligation being transferred, "all interest in any . . . equity interest . . . in any borrower or obligor" on that Collateral Debt Obligation.[114]

As a result of this transfer, Zohar II received from Ark I, *inter alia*, 74,033 Class A and 20,137 Class B shares of Glenoit common stock[115] and 590 shares of FSAR common stock.[116]

2. Zohar II Acquires Additional FSAR Equity from OFSI Fund II

On May 27, 2005, Zohar II acquired additional FSAR debt and equity from a third party, OFSI Fund II, LLC ("OFSI").[117] Specifically, Zohar II paid $12,723,830.75 cash and received from OFSI "all of [its] right, title, and interest in" the following:

- a revolving commitment to FSAR subsidiary Electro Source, LLC in the aggregate principal amount of $7,790,000.00, consisting of a revolving loan in the outstanding principal amount of $7,364,739.71 and an unfunded revolving commitment in the principal amount of $425,260.29;[118]

[114] JX 120 (Issuer Agreement) § 1(o)(ix).

[115] JX 132 (Ark I Obligors Letter), sched. C.

[116] JX 108 (Zohar II Indenture), sched. A-2; JX 120 (Issuer Agreement) §§ 1(o), 2, sched. 1; JX 1017 (Affidavit of Lost Certificate) at PP255_000011337, ¶¶ 2–3.

[117] JX 135.

[118] JX 135 at 1–3.

- an Electro Source term loan in the outstanding principal amount of $10,332,000.00;[119]
- an Electro Source term loan in the outstanding principal amount of $820,000;[120] *and*
- 410 shares of FSAR common stock.[121]

This transaction (the "Zohar II-OFSI Transfer") is memorialized in a "LSTA Purchase and Sale Agreement for Distressed Trades."[122] The LSTA Agreement uses the term "Transferred Rights" to refer to the subject matter of the Zohar II-OFSI Transfer.[123] "Transferred Rights" includes "all of [OFSI's] right, title, and interest in" (1) the Electro Source revolving commitment and term loans, and (2) the 410 shares of FSAR common stock.[124]

3. Zohar II Acquires Additional Glenoit Debt and Equity from BNP Paribas

On January 18, 2006, Zohar II acquired additional Glenoit debt and equity from third party, BNP Paribas.[125] Specifically, Zohar II paid $4,009,735.00 cash and

[119] JX 135 at 1–3.

[120] JX 135 at 1–3.

[121] JX 135 at 1, 7.

[122] JX 135.

[123] JX 135 at 7–8.

[124] JX 135 at 1–3, 7.

[125] JX 152.

received from BNP Paribas "all of [BNP Paribas's] right, title, and interest in" the following:

- a $5,378,633.22 term loan commitment to Glenoit LLC (Glenoit's wholly-owned subsidiary);[126]
- 78,561 Class A (voting) shares of Glenoit common stock;[127] *and*
- 21,369 Class B (nonvoting) shares of Glenoit common stock.[128]

This transaction (the "Zohar II-BNP Paribas Transfer") is memorialized in a "LSTA Purchase and Sale Agreement for Distressed Trades."[129] This LSTA Agreement again uses the term "Transferred Rights" to refer to the subject matter of the Transfer.[130] "Transferred Rights" includes "all of [BNP Paribas'] right, title, and interest in" (1) the Glenoit LLC term loan commitment; (2) the 78,561 Class A shares of Glenoit common stock; and (3) the 21,369 Class B shares of Glenoit common stock.[131]

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[126] JX 152 at 1, 7.

[127] JX 152 at 7.

[128] JX 152 at 7.

[129] JX 152.

[130] JX 152 at 1–3, 7–8.

[131] JX 152 at 7.

BNP Paribas also executed an "Assignment and Acceptance" in connection with the Zohar II-BNP Paribas Transfer.[132] In the Assignment and Acceptance, BNP Paribas represented and warranted that it was the "legal and beneficial owner of the interests being assigned" pursuant to that Transfer.[133]

4. Zohar II Acquires Additional Glenoit Debt and Equity from Deutsche Bank

On November 30, 2006, Zohar II acquired additional Glenoit debt and equity from a third party, Deutsche Bank AG Cayman Islands Branch ("Deutsche Bank").[134] Specifically, Zohar II paid $2,665,331.20 cash and received from Deutsche Bank "all of [Deutsche Bank's] right, title, and interest in" the following:

- a Glenoit LLC term loan commitment of $3,502,279.77;[135]
- 57,448 Class A shares of Glenoit common stock;[136] *and*
- 15,626 Class B shares of Glenoit common stock.[137]

[132] JX 152 at PP225_000008492.

[133] JX 152 at PP225_000008492.

[134] JX 184.

[135] JX 184 at 1–3, 7.

[136] JX 184 at 7–8; JX 587 (Glenoit stock certificates).

[137] JX 184 at 7–8; JX 587.

This transaction (the "Zohar II-Deutsche Bank Transfer") is memorialized in a "LSTA Purchase and Sale Agreement for Distressed Trades."[138] Again, the LSTA Agreement uses the term "Transferred Rights" to refer to the subject matter of the Transfer.[139] "Transferred Rights" includes "all of [Deutsche Bank's] right, title, and interest in" (1) the Glenoit LLC term loan commitment; (2) the 57,448 Class A shares of Glenoit common stock; and (3) the 15,626 Class B shares of Glenoit common stock.[140]

5. Zohar II and Zohar III Acquire UI Equity

Prior to 2008, the Zohar Funds had participated in a syndicated loan to UI.[141] That loan was restructured at the end of 2008 as follows:

- The Zohar Funds (and the other lenders) waived a covenant default, extended the loan's maturity by two years and extended another $10 million loan to UI.[142]
- In exchange, the Zohar Funds (and other lenders) received 100% of UI's stock, subject to a warrant of the existing owner of UI's equity (Francisco Partners) to acquire a 30% economic interest in UI.[143]

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[138] JX 184.

[139] JX 184 at 1–3, 7–8.

[140] JX 184 at 7–8; JX 587.

[141] JX 374 at 1.

[142] JX 374 at 1–3.

[143] JX 374 at 1–3.

This restructuring transaction (the "UI Restructuring") is memorialized in a "Sale, Settlement, and Release Agreement" dated December 31, 2008.[144] That agreement provides for the transfer of UI equity to the Zohar Funds:

- UI "hereby sells to the Agent (on behalf of the Lenders [including Zohar II and Zohar III]), free and clear of all liens and encumbrances, 100% of the outstanding equity interests in [UI]";[145] *and*

- "Upon Agent's request, [UI] will transfer the Shares directly to the Lenders in the amounts set forth on the signature pages . . . and shall deliver stock certificates representing the applicable Shares . . . to the applicable Lenders."[146]

The signature pages to the Sale, Settlement, and Release Agreement indicate that Zohar II received 54.9604 Class A and 2.8663 Class B shares of UI, and that Zohar III received 30.3621 Class A and 1.5834 Class B shares of UI.[147]

6. Zohar III Acquires Additional UI Debt and Equity from Platinum Grove

On December 23, 2010, Zohar III acquired additional UI debt and equity from a third party, Platinum Grove.[148] Specifically, Zohar III paid $5,792,030.08 cash

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[144] JX 374.

[145] JX 374 at 2.

[146] JX 374 at 2.

[147] JX 374 at S-2.

[148] JX 473. Platinum Grove's formal name is Platinum Grove Contingent Capital Master Fund Ltd. *Id.* at 1.

and acquired (1) a UI term loan in the outstanding principal amount of $6,435,588.98;[149] (2) 21.8674 Class A (voting) shares of UI;[150] and (3) 1.1404 Class B (non-voting) shares of UI.[151]

This transaction (the "Zohar III-Platinum Grove Transfer") is memorialized in a "LSTA Purchase and Sale Agreement for Distressed Trades."[152] Per the LSTA Agreement, "[Zohar III's] obligations to pay the Purchase Price [to Platinum Grove and] to acquire the Transferred Rights . . . shall be subject to the additional condition that [Platinum Grove] has completed the transfer to [Zohar III] . . . for no additional consideration . . . of 21.8674 shares of [UI's] Class A Voting Common Stock and 1.1404 shares of [UI's] Class B Non-Voting Common Stock . . . ."[153]

D. Tilton's Roles at the Portfolio Companies

As with the Ark funds, the plan for the Zohar Funds was that Tilton (through the Patriarch Managers) would take on an "active role" in managing—and rehabilitating—the Funds' portfolio companies.[154] This plan is reflected, among

[149] JX 473 at 1–3.

[150] JX 473 at 6.

[151] JX 473 at 6.

[152] JX 473.

[153] JX 473 at 6.

[154] TT 907:1–2 (Tilton).

other places, in the Zohar Funds' CMAs. Through the Patriarch Managers, Tilton was in a position to vote the stock of the Zohar Funds' portfolio companies and thereby control the composition of their directorship and management.[155] In turn, through the exercise of that control, Tilton came to "serve as the manager of the board of most of the portfolio companies" and, in some cases, as the companies' CEO.[156]

Tilton has been actively involved in the management of FSAR, Glenoit and UI.[157] As of November 2016, Tilton had served as FSAR's sole director for fifteen years, as UI's sole director for eight years and as a Glenoit director for twelve years.[158] Tilton also served as "managing director" of FSAR's operating subsidiary,

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[155] JX 114 (Zohar II CMA) § 2.2(c) ("The Collateral Manager shall make determinations with respect to the exercise or enforcement of any and all rights by the Company and/or the Zohar Subsidiary . . . or rights or remedies in connection with the Collateral and participating in the committees (official or otherwise) or other groups formed by creditors of a Debt Issuer . . . . [T]he Collateral Manager may, on behalf of the Company and/or the Zohar Subsidiary and without the consent of the holders of any Notes or any other Person, enter into any amendment, modification or waiver of, or supplement to, any term or condition of any Collateral, Collateral Debt Obligation, Unrestricted Collateral Debt Obligation, and/or Equity Security (including, without limitation and subject to the terms of the Indenture, exchanges thereof for other loans, equity or other securities), so long as such amendment, modification, waiver or supplement does not contravene the provisions of the Indenture or this Agreement or contravene any applicable law or regulation. . . ."); JX 246 (Zohar III CMA) § 2.2(c) (same); PTO ¶¶ 6, 10, 12, 16.

[156] TT 907:2–4 (Tilton).

[157] *See, e.g.*, TT 441:5–442:24 (O'Leary); TT 1738:1–21 (Richards); TT 1364:6-15 (Tilton).

[158] TT 1364:6–15 (Tilton).

PDP (beginning in 2005) and as the "designated executive" of UI (beginning in 2009).[159]

At trial, PDP's CEO, Christopher Richards, testified that Tilton was (and is) a very capable managing director. Richards explained, "[Tilton] has consistently pushed [PDP] to improve [its] growth, [its] sales, [its] profitability, and to look at all the deals that [PDP] work[s] on as inherently adding value and creating valuation for the company."[160] UI's CFO, Keith O'Leary, expressed similar sentiments in his trial testimony.[161]

Tilton also provided a suite of fee-based consulting and agency services to the Zohar Funds' portfolio companies through (separate) entities she controlled: Patriarch Partners Management Group ("PPMG") and Patriarch Partners Agency Services ("PPAS").[162] Thus, through the Patriarch Managers, PPMG and PPAS, Tilton was "involved in every aspect of the rebuilding of the[] [Zohar Funds' portfolio] companies," including FSAR, Glenoit and UI.[163]

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[159] TT 1732:24–1733:8 (Richards); TT 375:13–18, 435:16–436:11 (O'Leary).

[160] TT 1737:12–15 (Richards).

[161] TT 448:24–449:2 (O'Leary) ("[Tilton] challenges a lot of what [UI and UIC] do. She typically pushes us, I think, to perform at a higher level than we might otherwise do.").

[162] TT 906:5–10 (Tilton).

[163] TT 907:7–8 (Tilton).

E. The Irrevocable Proxies

Leading up to the fall of 2015, Tilton sensed that Zohar I was destined for default.[164] She was prescient; Zohar I defaulted in November 2015.[165] Soon after, Zohar II's Controlling Party, MBIA, began to look carefully at its exposure with respect to Zohar II.[166] And rightfully so. Following Zohar I's default, MBIA was on the hook for approximately $150 million to Zohar I noteholders.[167]

Tilton no doubt saw troubled waters ahead.[168] MBIA would soon be positioned to remove Patriarch Partners XIV as collateral manager for Zohar II.[169]

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[164] TT 728:21–729:11 (Tilton) ("Q: So [before you signed the proxy grants], what was impending was a default on Zohar I and the potential that you would be removed as collateral manager for Zohar I. Correct? A: Yes. . . .").

[165] TT 23:3–6 (LaPuma); TT 728:4–6 (Tilton).

[166] TT 1430:30–1431:16 (A. McKiernan).

[167] As noted, Zohar II ultimately failed to repay its Class A notes at their stated maturity (January 20, 2017), causing a default and triggering MBIA's guaranty obligation (as Credit Enhancer). JX 108 (Zohar II Indenture) §§ 2.2(b), 5.1(b); TT 24:8–12 (LaPuma); PTO ¶ 9. As a result, MBIA was required to pay approximately $770 million to Zohar II's Class A noteholders. TT 24:4–12, 157–58 (LaPuma); Avitable Dep. 39:15–20. In total, MBIA has paid out approximately $900 million as a result of Zohar I and Zohar II's defaults. TT 1434:18–1435:4 (McKiernan). MBIA now stands in the noteholders' shoes and is thus entitled to receive the proceeds from the sale of the Zohar I collateral and Zohar II collateral up to the amount paid to noteholders (in accordance with the respective "waterfalls" of Zohar I and Zohar II). JX 51 ("Zohar I Indenture") §§ 5.1(a), (b), (*l*), 5.4(a), 5.7, 11.1, 11.2; JX 108 (Zohar II Indenture) §§ 5.1(a), (b), (*l*), 5.4(a), 5.7, 11.1, 11.2.

[168] *See* TT 727:1–728:3, 728:21–729:11, 1146:1–1147:7, 1362:2–19 (Tilton).

[169] As noted earlier, MBIA had no ability to remove Zohar III's original collateral manager (Patriarch Partners XV), but Zohar III's Controlling Class did have that ability. JX 246 (Zohar III CMA) §§ 5.3, 5.4; TT 934:10–11, 968:20–970:9 (Tilton). It is reasonable to infer from the circumstances that Tilton also feared the Controlling Class would remove

Absent some other lever, the removal of the Patriarch Managers as collateral managers would jeopardize Tilton's control over the Zohar Funds and their portfolio companies and potentially threaten her interests as preference shareholder (through Octaluna II and Octaluna III).[170] By default, the removal would also jeopardize the substantial flow of fees Tilton received from the Zohar Funds (for the Patriarch Managers' collateral management services) and from the portfolio companies (for PPMG's consulting services and PPAS's agency services).[171] Her solution: construct the other lever—the Proxies.[172]

On September 21, 2015, while Tilton still maintained control over the Zohar Funds, she caused Zohar II to grant Patriarch Partners XIV (which she owns and controls)[173] three irrevocable proxies:

Patriarch Partners XV, which explains why she executed proxies relating to shares held by Zohar III and then caused Patriarch Partners XV to resign as Zohar III's collateral manager.

[170] *E.g.*, TT 1361:4–1362:21 (Tilton).

[171] *See, e.g.*, TT 1093:3–1096:18 (Tilton); JX 754 (showing UI's management fees going from $25,000 per month to $100,000 per month).

[172] *See* TT 1362:2–19 (Tilton) ("A: [O]nce I was no longer going to be in that collateral management role, I needed to make certain that I, as the owner of that equity and the person who needed to control the liabilities that I would be burdened or suffer with, needed to have that control over it. Q: And to keep control, you signed irrevocable proxies with yourself. Correct? A: I signed irrevocable proxies, as I sign everything with myself, because I wear all the hats, because I bear all the burden.").

[173] *See, e.g.*, TT 489:11–18 (Tilton) ("Patriarch Partners XIV is the owner of Octaluna II, which made the $38 million of loan assets and – they're all affiliated with me. Patriarch Partners XIV owns Octaluna II. Zohar Holdings owns Octaluna II, and Lynn Tilton owns Zohar Holdings."); TT 1361:23 (Tilton) ("I [am] Patriarch Partners XIV"); JX 186

- an irrevocable proxy for 1,000 shares of FSAR common stock, which purports to assign to Patriarch Partners XIV all voting rights in the shares of FSAR stock issued in Zohar II's name;[174]

- an irrevocable proxy for 210,042 shares of Glenoit Class A Common Stock, which purports to assign to Patriarch Partners XIV all voting rights in the shares of Glenoit voting stock issued in Zohar II's name;[175] *and*

- an irrevocable proxy for 54.96 shares of UI Class A voting stock, which purports to assign to Patriarch Partners XIV all voting rights in the shares of UI voting stock issued in Zohar II's name.[176]

That same day, Tilton caused Zohar III to grant Ark II (which Tilton owns and controls)[177] an irrevocable proxy for 52.23 shares of UI Class A voting stock, which purports to assign to Ark II all voting rights in the shares of UI voting stock issued in Zohar III's name.[178]

(LLC Agreement of Patriarch Partners XIV); JX 764 (signing proxy grant on behalf of Patriarch Partners XIV as "Manager").

[174] JX 764.

[175] JX 764.

[176] JX 764.

[177] *See, e.g.*, JX 766 (showing Tilton as "manager" of Ark II); JX 1058 (organizational chart).

[178] JX 766. Curiously, Ark II CLO 2001-1 is the entity that executed this proxy as Zohar III's collateral manager. *Id.* That entity was not the collateral manager; Patriarch Partners XV was the collateral manager. PTO ¶ 6.

Notably, all of the Proxies state that the Zohar Funds own the underlying shares.[179] Tilton signed the Proxies on behalf of both the grantors and grantees.[180]

F. The Written Consents

As observed in *Zohar I*, Tilton and her team appeared to cooperate with AMZM at the outset of the collateral manager transition process.[181] Unfortunately, that cooperation was short lived.[182] It appears that at least one cause of the breakdown in the transition process was Tilton's refusal to turn over "equity documents" relating to the Zohar funds' portfolio companies.[183] In April 2016, with AMZM officially at the helm of all three Zohar funds, the funds initiated the *Zohar I* litigation against their former collateral managers, Patriarch Partners VIII, Patriarch Partners XIV and Patriarch Partners XV, to enforce the funds' informational rights under the CMAs.[184] After trial, the Court entered judgment for the Zohar funds and

[179] JX 757–61 ("Whereas, Grantor is the owner . . . ."); JX 764–68 ("Whereas, Grantor is the owner . . . .").

[180] JX 757–61; JX 764–68.

[181] *Zohar I*, 2016 WL 6248461, at *4–5.

[182] *Id.* at *5–6.

[183] *Id.* at *5.

[184] *Id.* *6.

ordered Tilton's entities to produce designated books and records to the funds and their new collateral manager, AMZM.[185]

At this juncture, even though Tilton no longer controlled the Zohar Funds, she still retained control of their portfolio companies by virtue of her directorship and management positions at the companies. The Zohar Funds, now managed by AMZM, sought to remove Tilton from any decision-making role. On November 23, 2016, AMZM caused the Zohar Funds to deliver written consents to the three Portfolio Companies. The FSAR consent, executed by Zohar II, purports to remove Tilton as FSAR's sole director and replace her with non-parties Elizabeth LaPuma, Tom Jones and Daniel Avitabile.[186] The UI consent, executed by Zohar II and Zohar III, purports to remove Tilton as UI's sole director and replace her with LaPuma, Jones and Avitabile.[187] And the Glenoit consent, executed by Zohar II (along with several other Glenoit stockholders), purports to remove Tilton and non-

[185] *Id.* at *12–18.

[186] PTO ¶ 21; JX 918–19 (written consents). LaPuma is a managing director in the asset management division of Alvarez & Marsal ("A&M"), an AMZM affiliate. TT 21:23–22:17 (LaPuma). She is also the "day-to-day lead" with respect to the Zohar Funds at AMZM. TT 21:23–22:17 (LaPuma). Tom Jones is LaPuma's colleague at A&M. TT 35:19–23 (LaPuma). Avitable is MBIA's Chief Risk Officer. Avitable Dep. 13:16–21, 29:21–30:7.

[187] PTO ¶ 28.

party Michael Ricciarelli as directors of Glenoit and replace them with LaPuma and non-party Jonathan Sacks.[188]

On December 15, 2016, Zohar II delivered two additional written consents: one to FSAR and one to UI.[189] The second FSAR consent, executed by Zohar II, purports to remove Avitabile as a director of FSAR and replace him with non-party Kenneth Epstein.[190] The second UI consent, executed by Zohar II and Zohar III, purports to effect the same change with respect to UI's board.[191]

G. Procedural Posture

On November 29, 2016, the Zohar Funds filed a complaint under Section 225 of the DGCL[192] seeking a declaration that (1) the Consents delivered to the Portfolio Companies are valid and effective; and (2) that the Proxies signed by Tilton on their behalf are illegal, void and of no force or effect. Essentially, the Zohar Funds seek a declaration that their designees are the Portfolio Companies' rightful directors.

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[188] *Id.* ¶ 38. Zohar II executed the Glenoit consent along with affiliates of Stonehill Capital Management LLC ("Stonehill"), which (collectively) hold 346,305 shares of Glenoit's Class A voting stock and 94,194 shares of Glenoit's Class B non-voting stock. TT 231:14–234:4 (Sacks); PTO ¶ 33. Jonathan Sacks is a partner at Stonehill. TT 232:1–3 (Sacks).

[189] JX 930–31.

[190] PTO ¶ 22. Epstein is a managing director in MBIA's restructuring group. Epstein Dep. 15:23–16:23 (Apr. 13, 2017).

[191] PTO ¶ 29.

[192] 8 *Del. C.* § 225.

The Zohar Funds argue that they beneficially own the Portfolio Companies' equity, as evidenced by the Indentures and detailed transactional documents, and thus have the sole right to elect directors to the boards of those companies. They also contend that the Proxies are invalid and ineffective because (1) the Proxies do not comply with Section 212(e) of the DGCL;[193] and (2) the creation of the Proxies violated the Indentures. For all of these reasons, the Funds argue, the Court should give their Consents full force and effect.

Defendants deny that the Zohar Funds are entitled to the relief sought, and have filed counterclaims seeking counter-declarations that the Consents are invalid and ineffective. They also originally sought a declaration that Tilton (not the Zohar Funds) is the beneficial owner of the equity in the Portfolio Companies. After litigation was well underway, however, Tilton brought a motion to sever the beneficial ownership issue on the ground that the issue was beyond the limited focus of this Section 225 proceeding. The Court denied that motion because beneficial ownership is inextricably intertwined with the other issues presented.[194]

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[193] 8 *Del. C.* § 212(e).

[194] Transcript of Court's Ruling on Def. Tilton's Mot. to Sever (D.I. 341) ("Tr. of Mot. to Sever") 4:6–10:24; *see also Zohar II 2005-1, Ltd. v. FSAR Hldgs., Inc.*, 2017 WL 1382143, at *1–2 (Del. Ch. Apr. 17, 2017) (denying Tilton's motion for certification of interlocutory appeal), *appeal refused*, 159 A.3d 713 (Del. 2017) (TABLE).

Before trial, Tilton filed a motion for leave to file a motion for summary judgment or stay. The Court denied her motion to stay this proceeding but granted her motion for leave to argue for summary judgment in her pre- and post-trial briefs.[195]

In support of her motion for summary judgment, Tilton argues that the Court need look no further than the Proxies to resolve this dispute in her favor as a matter of law. According to Tilton, even if the Zohar Funds beneficially own the Portfolio Companies' equity (which she does not concede), the Proxies validly give her the exclusive right to elect the Portfolio Companies' directors. She also argues that the Court should refrain from reaching the beneficial ownership issue entirely because the Court does not have the authority to decide that issue under Section 225. Moreover, she contends that the Court would violate her due process rights by deciding that issue in this summary proceeding.

In the alternative, Tilton argues, if the Court must reach the beneficial ownership issue, then the Court should determine that she (through the various entities she controls) is the beneficial owner of the Portfolio Companies' equity.

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[195] D.I. 87; D.I. 99; *see also Grace Bros., Ltd. v. Siena Hldgs., Inc.*, 2009 WL 1799120, at *2 (Del. Ch. June 5, 2009) (noting that the court has "inherent power" to "manage its docket and the scheduling of cases," and, therefore, may postpone briefing and decision on a motion for summary judgment until after trial); *Miller v. Miller*, 2008 WL 372469, at *1 & n.3 (Del. Ch. Jan. 31, 2008) (stating the same with respect to a motion for judgment on the pleadings).

She argues that the Zohar Funds' Indentures prohibit them from owning the equity at issue and that this prohibition was central to the structure of the deals. In support of her argument, Tilton relies on internal documents and testimony from others involved in setting up the Zohar Funds to demonstrate that it was understood by all that she would be the beneficial owner of any equity ostensibly acquired by the Zohar Funds.

The Court held a six-day trial beginning on April 19, 2017, and thereafter heard post-trial argument on July 21, 2017. The parties submitted (unsolicited) additional arguments in September and October 2017. This is the Court's post-trial decision.

II. ANALYSIS

I first address Tilton's motion for summary judgment. As noted, Tilton argues that even if the Zohar Funds are the beneficial owners of the Portfolio Companies' equity, the Proxies are valid as a matter of law and, therefore, only she can vote the Portfolio Companies' shares. After considering Tilton's motion for summary judgment, I have concluded that the motion must be denied because (1) Tilton's interests (directly or indirectly) in the Portfolio Companies are not "coupled" with the Proxies; and (2) the Proxies are prohibited by the Zohar Funds' Indentures, and are thus invalid and ineffective.

Having determined that the Proxies are invalid, the Court must address the parties' competing claims to beneficial ownership of the Portfolio Companies' stock, as that is the only basis on which the Court can determine who belongs on the boards of these companies. Before reaching the merits of the beneficial ownership issue, however, I must first address Tilton's contention that the Court lacks the authority to decide beneficial ownership in a Section 225 action, and her claim that the Court would violate her due process rights by deciding that issue. For reasons explained below, I have concluded that the Court has the authority to decide beneficial ownership in this Section 225 action, and that deciding the issue in this instance does not deny Tilton due process.

Having determined that Tilton's threshold legal arguments lack merit, the Court thus reaches the merits of the beneficial ownership issue. After carefully considering the evidence and applying settled principles of contract construction, I conclude that the Zohar Funds are the beneficial owners of the disputed equity in the Portfolio Companies. This conclusion is dictated by the plain language of the relevant transactional documents. The sole remaining issue, then, is whether the Zohar Funds' Consents are valid and effective. They are. Accordingly, judgment will be entered in favor of the Zohar Funds.

A. The Irrevocable Proxies are Invalid and Ineffective

Tilton's motion for summary judgment presents two issues: (1) whether the Proxies are valid and effective; and, if so, (2) whether that determination renders the Zohar Funds' Consents invalid and ineffective. For reasons discussed below, the Court need not reach the second issue.

To briefly reset the stage, once it was clear that Tilton was going to be replaced as collateral manager of the Zohar Funds, she caused the Zohar Funds (through the Patriarch Managers) to grant irrevocable proxies for shares of the Portfolio Companies' stock to Patriarch Partners XIV and Ark II (both of which she controls).[196] The Proxies state that they are irrevocable[197] and describe the Zohar Funds as the "owner" of the underlying stock.[198] They also purport to vest the grantees with the "exclusive right to vote" the underlying stock and state, conversely, that the Zohar Funds "shall not have any such rights."[199]

According to Tilton, the Proxies give her the exclusive right to vote the disputed shares because the Proxies were validly executed and are coupled with her

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[196] JX 757–61, 764–68; *see also supra* note 173 (regarding control); JX 766 (showing Tilton as "manager" of Ark II); JX 1058 (organizational chart).

[197] *See, e.g.*, JX 761 at 1.

[198] JX 761 at 1.

[199] JX 761 at 2. The "exclusive right to vote" includes the right to vote on "[t]he election or removal of directors of the [Portfolio] Compan[ies]." *Id.* at 1.

interest as a director of the Portfolio Companies or preference shareholder of the Zohar Funds (or both), in compliance with Section 212(e)'s irrevocability requirements.[200] The Zohar Funds disagree on all fronts. They contend that the Proxies are invalid and ineffective because (1) they are not coupled with a sufficient interest and (2) Tilton violated the Indentures' negative covenants in creating them. Finally, the Zohar Funds argue that, as a matter of equity, the Court should strike down the Proxies as a remedy to correct Tilton's improper self-dealing, even if the Proxies are otherwise valid.

Proxies are evidence of an agency relationship,[201] and the agent-proxy holder must "act[] in strict accord with those requirements of a fiduciary relationship which inhere in the conception of agency."[202] Given the fiduciary responsibilities created

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[200] Tilton also argued in her post-trial brief that her (claimed) interest as the ultimate beneficial owner of the Portfolio Companies' equity is a sufficient interest, but in the next sentence stated that the Court "need not reach the question of equity ownership." Def. Lynn Tilton's Post-Trial Opening Br. ("DPTB") 85–86.

[201] *See Parshalle v. Roy*, 567 A.2d 19, 27 (Del. Ch. 1989) ("[T]o be accepted as valid evidence of an agency relationship, the proxy must evidence that relationship in some authentic, genuine way.").

[202] *Rice & Hutchins, Inc. v. Triplex Shoe Co.*, 147 A. 317, 322 (Del. Ch. 1929), *aff'd*, 152 A. 342 (Del. 1930); *see also In re MONY Grp., Inc. S'holder Litig.*, 853 A.2d 661, 680 (Del. Ch. 2004) ("[I]t has been noted that the integrity of the entire proxy voting procedure necessarily and implicitly rests upon the premise that the agency relationship is genuine and, correlatively, that the proxy instrument accurately and reliably evidences that relationship.") (citation omitted) (internal quotation marks omitted); *Hauth v. Giant Portland Cement Co.*, 96 A.2d 233, 235 (Del. Ch. 1953) ("The person designated in a proxy has a fiduciary obligation to carry out the wishes of the stockholders to the best of his ability.").

by a proxy, Section 212(e) of the DGCL provides that certain predicates must be in place before the proxy will be deemed irrevocable:

> A duly executed proxy shall be irrevocable if it states that it is irrevocable and if, and only as long as, it is coupled with an interest sufficient in law to support an irrevocable power. A proxy may be made irrevocable regardless of whether the interest with which it is coupled is an interest in the stock itself or an interest in the corporation generally.[203]

The Proxies at issue here cannot be deemed irrevocable because they are not "coupled" with a sufficient interest of the Proxy holder as required by Section 212(e). Tilton argues that her indirect economic interests in the Portfolio Companies and her position as director of those Companies constitutes a valid interest "sufficient in law to support an irrevocable power."[204] After considering Chancellor Allen's decision in *Haft v. Haft*[205] and its progeny,[206] I agree with Tilton that these interests (taken together) might well be "sufficient" interests to support irrevocability under Section 212(e).[207] But the problem Tilton faces is that neither

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[203] 8 *Del. C.* § 212(e).

[204] *Id.* To be clear, Tilton's claimed economic interests arise from the Zohar Funds' preference shares, which are held directly by Octaluna II and Octaluna III. *See* PTO ¶ 6.

[205] 671 A.2d 413, 420–23 (Del. Ch. 1995) (holding that the proxy holder's position as CEO was a sufficient interest under Section 212(e)).

[206] *See, e.g.*, *Aveta Inc. v. Cavallieri*, 23 A.3d 157, 168–69 (Del. Ch. 2010) (discussing the "sufficient interest" requirement of Section 212(e)).

[207] Although the Court is not aware of any Delaware decision holding that a directorship is a sufficient interest, *Haft* relied in part on a Pennsylvania decision, *Deibler v. Chas. H.*

of the "interests" she has identified is "coupled" with the Proxies.[208] Patriarch Partners XIV and Ark II hold the Proxies, not Tilton personally and not either of the preference shareholders.

According to the plain meaning of the word "couple" in Section 212(e), the "sufficient interest" and the proxy must be joined or bound together in the same person or entity. "'In the construction of a statute, this Court has established as its standard the search for legislative intent. Where the intent of the legislature is clearly reflected by unambiguous language in the statute, the language itself controls.'"[209] In the search for legislative intent, Delaware courts often turn to dictionaries to discern the ordinary meaning of statutory language.[210] Webster's Dictionary defines the verb "couple" as "to connect for consideration together; to join for combined effect; to fasten together; link."[211] This notion of "coupling" in the irrevocable proxy

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Elliott Co., 81 A.2d 557, 558 (Pa. 1951), where the Pennsylvania Supreme Court, applying Delaware law, held that such an interest was sufficient. *See Haft*, 671 A.2d at 421.

[208] 8 *Del. C.* § 212(e).

[209] *Zambrana v. State*, 118 A.3d 773, 775 (Del. 2015) (quoting *Spielberg v. State*, 558 A.2d 291, 293 (Del. 1989)).

[210] *Freeman v. X-Ray Assocs., P.A.*, 3 A.3d 224, 227–28 (Del. 2010) ("We must give effect to the legislature's intent by ascertaining the plain meaning of the language used. . . . Because dictionaries are routine reference sources that reasonable persons use to determine the ordinary meaning of words, we often rely on them for assistance in determining the plain meaning of undefined terms.").

[211] *Couple Definition*, Merriam-Webster, https://www.merriam-webster.com/dictionary/couple%20with (last visited Nov. 30, 2017); *see also Couple Definition*, Dictionary.com,

context as a "fastening together" requires that the "power and the interest be in the same person."[212] This required coupling did not occur here because the "sufficient" interest and the Proxies never came together in the same person or entity.

Delaware courts respect the separate legal existence of corporate entities.[213] With this in mind, Tilton has not provided any basis in law that would allow the Court to ignore the separate legal entity status of Patriarch Partners XIV and Ark II (which do not possess the interests proferred by Tilton) in considering whether the Proxies are "coupled" with a "sufficient" interest for purposes of Section 212(e). Stated differently, the Proxies cannot be deemed irrevocable because the holders of the Proxies lack "an interest sufficient in law to support an irrevocable power."

Chancellor Allen cautioned in *Haft* that "the exercise of voting control over corporations by persons whose interest in them is not chiefly or solely as a residual owner will create circumstances in which the corporation will be less than optimally

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http://www.dictionary.com/ browse/couple?s=t ("to join; connect") (last visited Nov. 30, 2017).

[212] 18A Am. Jur. 2d Corporations § 904 (Westlaw version updated 2017) ("The power and the interest must be in the same person, and it is not sufficient that the holder of the proxy is compensated for acting as a proxy.").

[213] *Allied Capital Corp. v. GC-Sun Hldgs., L.P.*, 910 A.2d 1020, 1038 (Del. Ch. 2006) ("[O]ur corporation law is largely built on the idea that the separate legal existence of corporate entities should be respected—even when those separate corporate entities are under common ownership and control.").

efficient in the selection of risky investment projects."[214] That sage warning is particularly apt here, where the Proxy holders independently have no legally cognizable "interests" (either as director of the Portfolio Companies or preference shareholders of the Zohar Funds). The Court risks setting a dangerous precedent if it upholds an irrevocable proxy when one person holds the valid interest and a separate person or entity holds the proxy. It is tempting to elide the distinction between Tilton and the Proxy holders in this case because there is no doubt she controls them. But establishing a judicially created rule that allows the court to presuppose that a proxy holder has a sufficient interest simply because its controller has a sufficient interest would impermissibly modify the statute's plain and clear requirement that the "sufficient interest" and the proxy be "coupled."[215] It would also produce uncertainty and imprecise line drawing in future cases. I am satisfied that Section 212(e) requires that the same person or entity hold both the supporting interest and the proxy in order to satisfy the statute's "coupling" requirement.[216]

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[214] *Haft*, 671 A.2d at 421.

[215] *See* 8 *Del. C.* § 212(e); *see also Zambrana*, 118 A.3d at 775 ("'Where the intent of the legislature is clearly reflected by unambiguous language in the statute, the language itself controls.'") (quoting *Spielberg*, 558 A.2d at 293).

[216] *See* 8 *Del. C.* § 212(e). I note that neither party expressly addressed the "coupling" issue in their pre- or post-trial briefs. Tilton did, however, move for summary judgment, *inter alia*, on the ground that the Proxies complied in all respects with Section 212(e). Accordingly, the Court may, *sua sponte*, consider whether that claim stands up to careful statutory construction. For the reasons just stated, it does not. *See Stroud v. Grace*, 606 A.2d 75, 81 (Del. 1992) ("[I]n the interests of judicial economy, Court of Chancery

Thus, the Proxies are revocable, if they are valid at all. The Zohar Funds are the principals in the agency relationships the Proxies purportedly created.[217] The Zohar Funds revoked the Proxies when they voted the Portfolio Companies' shares, as this was a clear manifestation inconsistent with the proxy grants, and the agents had notice of the revocation upon the Zohar Funds' delivering the Consents.[218] Revoked Proxies cannot undo otherwise valid Consents.

The Proxies are unenforceable for the additional reason that their creation caused a transfer of (and possibly encumbered) the voting rights attached to the Portfolio Companies' shares, in violation of Section 7.8(a)(i) of the Indentures.[219] Our Supreme Court held in *Crown EMAK Partners, LLC v. Kurz* that a party cannot

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Rule 56 gives th[e] court the inherent authority to grant summary judgment *sua sponte* against a party seeking summary judgment.") (citing *Bank of Del. v. Claymont Fire Co. No. 1*, 528 A.2d 1196, 1199 (Del. 1987)).

[217] JX 757–61 ("Whereas, Grantor is the owner . . . ."); JX 764–68 ("Whereas, Grantor is the owner . . . .").

[218] *See, e.g.*, JX 918–19 (written consents purporting to remove Tilton (the Proxy holders' principal) and elect new directors); JX 927 (Patriarch Partners Email showing notice); *see also* Restatement (Third) Agency § 3.10 (2006) ("Notwithstanding any agreement between principal and agent, an agent's actual authority terminates . . . if the principal revokes the agent's actual authority by a manifestation to the agent. A revocation or a renunciation is effective when the other party has notice of it.").

[219] JX 108 (Zohar II Indenture) § 7.8(a)(i); JX 1042 (Zohar III Indenture) § 7.8(a)(i).

exercise voting rights that it obtains from another in breach of contract.[220] That is precisely what has occurred here.

Section 7.8(a)(i)'s language closely tracks the language of the contracts at issue in *Crown EMAK*,[221] except that the prohibition in Section 7.8(a)(i) is even broader. Under Section 7.8(a)(i), the Zohar Funds may not "sell, transfer, exchange or otherwise dispose of, or pledge, mortgage, hypothecate or otherwise encumber (or permit such to occur or suffer such to exist), *any part of the Collateral*, except as expressly permitted by th[e] Indenture[s]."[222] There can be no doubt that the Portfolio Companies' shares are "Collateral."[223] Because the shares are Collateral,

[220] 992 A.2d 377, 392 (Del. 2010) (holding that the transfer of voting and economic rights was invalid because it violated a transfer restriction in a restricted stock grant agreement).

[221] In *Crown EMAK*, the seller was subject to a Restricted Stock Grant Agreement that provided, "[Seller] shall not be entitled to transfer, sell, pledge, hypothecate or assign any shares of Restricted Stock." *Id.* at 390.

[222] JX 108 (Zohar II Indenture) § 7.8(a)(i) (emphasis supplied); JX 1042 (Zohar III Indenture) § 7.8(a)(i) (same).

[223] This point is addressed more fully in the discussion of equity ownership, but it is sufficient for now to note the broad definition of "Collateral." *E.g.*, JX 108 (Zohar II Indenture) § 1.1 (defining "Collateral" as "All Money, instruments, accounts, payment intangibles, general intangibles, letter-of-credit rights, chattel paper, electronic chattel paper, deposit accounts, *investment property and other property* and rights subject or intended to be subject to the lien of this Indenture for the benefit of the Secured Parties as of any particular time pursuant to the Granting Clauses of this Indenture.") (emphasis supplied); JX 1042 (Zohar III Indenture) § 1.1 (same).

and because voting rights are a "part of" those shares,[224] any transfer or encumbrance of those voting rights through the Proxies violated Section 7.8(a)(i) of the Indentures.

The stated purpose of the Proxies was to transfer exclusive voting rights from the Zohar Funds to the Proxy holders.[225] Additionally, the Portfolio Companies' shares were "encumbered" in the sense that the Proxies are a "liability that is attached to property" which "may lessen [the property's] value."[226] There is little doubt that shares subject to an irrevocable proxy are not as valuable as shares free of such a proxy.[227] Nor can there be a doubt that an irrevocable proxy is a "liability" given the risk that the proxy holder may vote the shares differently than the stockholder-grantor desires. Since the Proxies "transferred" voting rights attendant

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[224] *See Crown EMAK*, 992 A.2d at 390–92 (noting that "full" stock ownership "consists of voting ownership plus direct economic ownership") (quoting Henry T.C. Hu & Bernard Black, *Empty Voting and Hidden (Morphable) Ownership: Taxonomy, Implications, and Reforms*, 61 Bus. Law. 1011, 1022 (2006)).

[225] *See, e.g.*, JX 766 at 2 ("Exclusive Proxy. The parties hereto expressly acknowledge and agree that this Irrevocable Proxy gives Grantee the exclusive right to vote (or consent) with respect to the Shares of the Company . . . and that the Grantor shall not have any such rights.").

[226] Black's Law Dictionary 607 (9th ed. 2009) (defining "encumbrance").

[227] *See Carlton Invs. v. TLC Beatrice Int'l Hldgs., Inc.*, 1996 WL 189435, at *3–4 (Del. Ch. Apr. 16, 1996) (Allen, C.) (observing that irrevocable proxies deprived stock of "valuable voting rights" and "it would be hard to contend that the company could not have gotten a higher price for shares *with* voting rights") (emphasis in original); *see also* Dale A. Oesterle & Alan R. Palmiter, *Judicial Schizophrenia in Shareholder Voting Cases*, 79 Iowa L. Rev. 485, 516–19 (1994) (discussing the "relative value of voting rights to various corporate constituencies").

to the underlying shares and "encumbered" those shares, the Proxies' creation constituted a clear violation of Section 7.8(a)(i) of the Indentures. Consequently, the Proxies are invalid and ineffective for this reason as well.

Tilton's motion for summary judgment is denied. The Proxies do not bear on the rightful composition of the Portfolio Companies' management.[228]

B. The Court May Decide the Beneficial Ownership Dispute

Tilton has asked the Court to ignore the parties' competing beneficial ownership claims and resolve this dispute solely based on the Proxies and Consents.[229] Her two bases for this argument are that the Court lacks authority to adjudicate beneficial ownership in a Section 225 proceeding, and that the Court would violate her due process rights if it determined beneficial ownership in this summary proceeding. I disagree on both fronts.

Because the Proxies are invalid and ineffective, only the beneficial owner's vote of the Portfolio Company's stock can been deemed valid and effective.[230] Both

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[228] Because the Court resolves Tilton's motion for summary judgment on the grounds discussed above, I need not consider whether the Proxies can or should be set aside on equitable grounds.

[229] Specifically, in the event the Court does not rule in her favor on the proxy issue, Tilton requests that the Court grant the Zohar Funds limited relief by declaring that the Consents are valid—and nothing more. Tr. of Mot. to Sever 17–23. The parties could then, according to her proposal, litigate the beneficial ownership issue in yet another action, in Delaware or elsewhere. *Id.*

[230] *See* 8 *Del. C.* § 212(a)–(b) (governing the voting rights of stockholders); *see also Bay Newfoundland Co. v. Wilson & Co.*, 37 A.2d 59, 63 (Del. 1944) ("The registered holder

Tilton and the Zohar Funds maintain that they are the beneficial owners. Any judgment in this Section 225 action that does not resolve their dispute over beneficial ownership will be meaningless. Even if the Court somehow were to reach a point where it could address the validity of the Consents without deciding the ownership issue, the unsuccessful party would most certainly initiate yet another action to undo that determination by seeking a definitive declaration regarding equity ownership. That, in turn, would leave the question at the heart of this Section 225 proceeding—who are the proper directors of the Portfolio Companies—in a state of indefinite suspension until that later action is adjudicated. That runs contrary to the purpose of Section 225 and simply makes no sense.

Before addressing the merits of the beneficial ownership dispute, I must first consider whether the Court lacks the authority to adjudicate beneficial ownership in a Section 225 proceeding (as Tilton argues). I need look no further than the statute and its legislative history to find the answer.[231] As discussed below, the rule that has

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would not be recognized in equity as entitled to vote [the shares] against [the beneficial owner's] wishes."); *Len v. Fuller*, 1997 WL 305833, at *3 (Del. Ch. May 30, 1997) (observing that the court may "specifically enforce . . . the registered owner vote as the beneficial holder requires."); *In re Canal Constr. Co.*, 182 A. 545, 548 (Del. Ch. 1936) ("[C]ourts [have] recognized the equity of the true owner of stock to control its voting power as against the registered holder, that the latter has been required to deliver a proxy to the former.").

[231] I review the legislative history to clarify the development of the law during Section 225(a)'s evolution. I do not use legislative history to assist in statutory interpretation. As discussed later, the plain text of Sections 225(a) and 227(a) is clear.

developed over the history of Section 225 is that the court may address any issue that will aid in determining the "proper composition of the corporation's board or management team."[232]

Section 225(a) has remained largely unchanged since the early 1900s.[233] Beginning in 1964, Professor Ernest Folk studied Sections 225 and 227 as part of the 1967 DGCL revisions,[234] and concluded that there was no need for any material changes.[235] The Delaware Corporation Law Study Committee agreed.[236] Professor

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[232] *Agranoff v. Miller*, 1999 WL 219650, at *17 (Del. Ch. Apr. 12, 1999) (Strine V.C.), *aff'd as modified*, 737 A.2d 530 (Del. 1999) (TABLE).

[233] Section 225(a) was originally part of Section 2063 under the 1935 code, which also included the text for what are now Sections 224, 226 and 227. *Del. C.* 1935, § 2063. The 1949 Amendment split these provisions into the separate statutes that are in the current version of the DGCL. 47 Del. Laws, ch. 136, § 5. The General Assembly made minor linguistic changes in 1949. *See* 8 *Del. C.* § 225 (1953). The 1949 text of the provisions relevant here is virtually identical to the current version of Section 225(a). 8 *Del. C.* § 225(a).

[234] Professor Folk's recommendations were fundamental in constructing the final version of the 1967 revisions, as to the DGCL generally and Section 225 in particular. *See* Minutes of the First Meeting of Delaware Corporation Law Study Committee 1 (1964); Minutes of the Third Meeting of Delaware Corporation Law Committee 1 (1964); Minutes of the Fourteenth Meeting of Delaware Corporation Law Study Committee 1 (1965).

[235] *See* Ernest L. Folk, III, Review of the Delaware General Corporation Law 150 (1965–67) ("Section 225 and its related Section 227, are sound in principle and the language is adequate."); *see also* Ernest L. Folk, III, The Delaware General Corporation Law: A Commentary and Analysis 266 (1972) [hereinafter "Folk, Commentary and Analysis"] (observing that the text of the revised Section 225 "is virtually unchanged from its counterpart in the old statute, apart from a few linguistic revisions which make no alterations of substance").

[236] Minutes of the Fourteenth Meeting at 1 ("The committee considered the Folk report (Par. N – Page 150) concerning the Review of Elections, Sections 225 and 227 of the

Folk observed, consistent with precedent at that time, that the Court of Chancery has broad powers under Section 225.[237] Specific to the issue now before the Court, he wrote that "the court can go beyond a mere determination of voting rights and finally adjudicate the ownership of stock . . . if the parties stipulate for such a determination or if the parties are before the court by effective service of process."[238]

While this exercise in time travel certainly informs the answer to Tilton's contention that the Court lacks authority to decide the equity ownership issue, there is also guidance to be found in cracking open the current version of the DGCL, where Section 225(a) makes clear that the Court of Chancery may

> hear and determine the validity of any election, appointment, removal or resignation of any director or officer of any corporation, and the right of any person to hold or continue to hold such office, and, in case any such office is claimed by more than 1 person, may determine the person entitled thereto; and to that end make such order or decree in any such case as may be just and proper . . . .[239]

Statute. It was the consensus that no change was needed or desirable."); Hon. Clarence A. Sutherland, Memorandum to Members of the Delaware Corporation Law Revision Committee (Mar. 30, 1965) ("Folk recommends no change, and I agree.").

[237] Folk, Commentary and Analysis, *supra* note 235, at 266 ("The statute dispel[s] the ensuing doubts as to the plentitude of the Court of Chancery's powers."); *see also Grossman v. Liberty Leasing Co.*, 295 A.2d 749, 752 (Del. Ch. 1972) (Duffy, C.) ("[Section 225] is broad in language and purpose . . . .").

[238] Folk, Commentary and Analysis, *supra* note 235, at 270 (citing *Mercer v. Rockwell Oil Co.*, 68 A.2d 721 (Del. Ch. 1949) (Seitz, V.C.); *Rosenfeld v. Standard Elec. Equip. Corp.*, 83 A.2d 843, 845 (Del. Ch. 1951) (Seitz, C.); *Standard Scale & Supply Corp. v. Chappel*, 141 A. 191, 194 (Del. 1928)).

[239] 8 *Del. C.* § 225(a).

Section 227(a), in turn, provides that "[t]he Court of Chancery, in any proceeding instituted under . . . § 225 of this title may determine the right and power of persons claiming to own stock to vote at any meeting of the stockholders."[240]

Consistent with the heritage of the statute, the plain language of the operative provisions of the current DGCL makes clear that the court may resolve beneficial ownership claims in a Section 225 proceeding.[241] By granting the Court of Chancery the power to determine the "validity" of an election and the "right" of a person to hold office as a director, Section 225(a) implicitly grants the court the power to adjudicate a dispute over beneficial ownership if doing so is necessary to determine the valid and rightful directors of a Delaware corporation. Indeed, this court has observed that "[i]n exercising that power, the court may determine any legal or factual issue, the resolution of which could affect the outcome of a corporate election or of any other stockholder vote."[242] That includes deciding beneficial ownership.[243]

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[240] 8 *Del. C.* § 227(a).

[241] *Freeman*, 3 A.3d at 227 ("We must give effect to the legislature's intent by ascertaining the plain meaning of the language used.").

[242] *In re Bigmar, Inc., Section 225 Litig.*, 2002 WL 550469, at *17 (Del. Ch. Apr. 5, 2002).

[243] *Southpaw Credit Opportunity Master Fund, L.P. v. Roma Restaurant Hldgs., Inc.*, 2017 WL 4570612, at *3 (Del. Ch. Oct. 13, 2017) (observing that the Court of Chancery may invalidate a stock issuance or transfer in a Section 225 proceeding); *Standard Scale*, 141 A. at 194 (observing that the Court of Chancery has the power to decide beneficial ownership if the purported owner is a party to the proceeding); *Rosenfield*, 83 A.2d at 845 (same); *Mercer*, 68 A.2d at 721 (deciding which party owned stock in subject company).

It is true, as Tilton argues, that "[a] Section 225 proceeding is summary in character."[244] It is also true that "[t]he purpose of a Section 225 action 'is to provide a quick method for review of the corporate election process to prevent a Delaware corporation from being immobilized by controversies about whether a given officer or director is properly holding office.'"[245] Notwithstanding the summary nature of the proceedings, however, "'[i]n determining what claims are cognizable in a [Section] 225 action, the most important question that must be answered is whether the claims, if meritorious, would help the court decide the proper composition of the corporation's board or management team.'"[246]

In this case, upon confronting the "important question" of what claims must be addressed to decide the proper composition of the Portfolio Companies' boards,[247] it is obvious that the Court must address beneficial ownership.[248] Indeed,

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[244] *Genger v. TR Investors, LLC*, 26 A.3d 180, 199 (Del. 2011) (citation omitted).

[245] *Id.* (quoting *Box v. Box*, 697 A.2d 395, 398 (Del. 1997)).

[246] *Id.* (quoting *Agranoff*, 1999 WL 219650, at *17, *aff'd as modified*, 737 A.2d 530).

[247] *Id.*

[248] *See Atkins v. Hiram*, 1993 WL 545416, at *5 (Del. Ch. Dec. 23, 1993) ("The reason for a summary proceeding is to preclude a leaderless, and therefore foundering, corporation."); *Concord Fin. Gp., Inc. v. Tri-State Motor Transit Co. of Del.*, 567 A.2d 1, 6 (Del. Ch. 1989) ("[T]he policy against stockholder disenfranchisement is counterbalanced, in appropriate circumstances, by the need for finality in corporate elections, in order to avoid a prolongation of internal strife.") (citing *Williams v. Sterling Oil of Okla.*, 273 A.2d 264, 265 (Del. 1971)).

Tilton herself has raised the question by maintaining from the outset of the litigation that she is the beneficial owner of the shares at issue, and that the Zohar Funds cannot vote those shares against her interests.[249] The question is front and center, not collateral,[250] and the Court must answer it in order to fulfill its task under Sections 225(a) and 227(a).[251] Moreover, avoiding the issue is almost certain to lead to serial litigation and an immense waste of judicial (and litigant) resources.

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[249] Tilton introduced that claim into this case in her counterclaims. Tilton's Countercl. ¶¶ 1, 15–21, 46, 49, 57–60, 80–92. She expressly sought an order declaring that she was the beneficial owner of the disputed equity. *Id.* ¶ E (Prayer for Relief). Tilton also has conflated herself with the entities that she controls by arguing that she (personally) is the beneficial owner of the disputed shares. *See, e.g.*, TT 698:5–8 (Tilton) ("I mean, you know, as Octaluna, I own all of this.").

[250] *See Genger*, 26 A.3d at 199 & n.83 (noting that a "Section 225 action should not be used for trying purely collateral issues"); *Southpaw*, 2017 WL 4570612, at *3 ("Delaware law grants this Court the authority to consider the validity of [stock] issuances in a Section 225 action to decide the proper composition of the board, and thus, the Court has subject matter jurisdiction [over such disputes]."); *Agranoff*, 1999 WL 219650, at *18 n.27 (collecting cases that illustrate the various claims adjudicated under Section 225).

[251] The Delaware Supreme Court touched on the beneficial ownership issue in *Genger v. TR Investors*, which the parties in this case did not cite. 26 A.3d at 199–202. *Genger* held that the Court of Chancery could not invalidate a stock transfer as to a non-party transferee because the plaintiff had not "formally summoned" the transferee and the court lacked *in personam* jurisdiction. *Id.* at 199–202 & n.93. The Supreme Court acknowledged, however, that this Court may decide beneficial ownership if the purported owners are properly before the court. *Id.* at 202–03 (stating that the court may decide beneficial ownership if the purported owners are parties in the proceeding); *see also Southpaw*, 2017 WL 4570612, at *3 & nn.31–35. In this case, neither party has advanced the argument that the beneficial owner of the Portfolio Companies' equity is not properly before the Court, they just disagree who that owner is. Of course, because the parties did not cite *Genger*, they are deemed to have waived any argument based upon that decision. *See Hokanson v. Petty*, 2008 WL 5169633, at *6 n.22 (Del. Ch. Dec. 10, 2008) (citing *Emerald P'rs v.*

C. Determining Beneficial Ownership Does Not Violate Due Process

Tilton's due process argument asks whether the Due Process Clause of the Fourteenth Amendment to the U.S. Constitution requires the Court to afford Tilton greater procedural safeguards than those provided her during discovery, the six-day trial and extensive post-trial arguments.[252] According to Tilton, the Court did not afford her adequate time in this Section 225 proceeding to advance her arguments on the issue of beneficial ownership.[253] Here again, I disagree.

Our federal and state constitutions provide that the government shall not deprive any person of life, liberty or property without due process of law.[254]

Berlin, 2003 WL 21003437, at *43 (Del. Ch. Apr. 28, 2003), *aff'd*, 840 A.2d 641 (Del. 2003)).

[252] *See* U.S. Const., Amend. XIV, § 1.

[253] *See* Tr. of Mot. to Sever 23:11–15.

[254] U.S. Const., Amend. XIV, § 1; Del. Const. Art. I, § 9; *see also Watson v. Div. of Family Servs.*, 813 A.2d 1101, 1107 (Del. 2002) ("[T]his Court's construction of the Delaware Constitution's mandate for due process . . . has been consistent with the flexible standards of due process enunciated by the United States Supreme Court in *Mathews v. Eldridge*."). Notably, Tilton has not satisfied the requirements imposed by our Supreme Court to state a claim under our State's constitution. *Wallace v. State*, 956 A.2d 630, 637–38 (Del. 2008) ("A proper presentation of an alleged violation of the Delaware Constitution should include a discussion and analysis of one or more of the following non-exclusive criteria: textual language, legislative history, preexisting state law, structural differences, matters of particular state interest or local concern, state traditions, and public attitudes.") (citation omitted) (internal quotation marks omitted). Tilton has addressed none of these topics to make out a claim under the Delaware Constitution.

Procedural due process is not a rigid protection divorced from circumstance.[255] Its contours, instead, depend very much on context.[256] At its core, procedural due process requires that the government afford a person notice and a hearing before depriving that person of a protected interest.[257] In determining the specific procedures demanded by due process, our courts turn to the balancing test set forth in *Mathews v. Eldridge*.[258]

> The '*Eldridge* factors' instruct a Court to balance: the private interest that will be affected by the official action; the risk of an erroneous deprivation of such interest through the procedures used, and the probable value, if any, of additional or substitute procedural safeguards; and finally, the Government's interest, including the function involved and the fiscal and administrative burdens that the additional or substitute procedures would entail.[259]

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[255] *Gilbert v. Homer*, 520 U.S. 924, 930 (1997) ("[D]ue process is flexible and calls for such procedural protections as the particular situation demands.") (quoting *Morrissey v. Brewer*, 408 U.S. 471, 481 (1972)).

[256] *Id.*

[257] *Mathews v. Eldridge*, 424 U.S. 319, 348–49 (1976) ("The essence of due process is the requirement that a person in jeopardy of serious loss be given notice of the case against him and opportunity to meet it.") (citation omitted) (internal quotation marks omitted).

[258] *Id.* at 334–35; *see also Cohen v. State ex rel. Stewart*, 89 A.3d 65, 87 (Del. 2014) (applying the *Mathews v. Eldridge* balancing test).

[259] *Cohen*, 89 A.3d at 87; *see also Tilden v. Hayward*, 1990 WL 131162, at *5 (Del. Ch. Sept. 10, 1990) (applying the *Mathews v. Eldridge* balancing test); *Ford v. Dept. of Pub. Instruction*, 1997 WL 817864, at *3 (Del. Super. Nov. 24, 1997) (same).

The private interests at stake are property interests—Tilton's claimed beneficial ownership of the Portfolio Companies' shares.[260] To be sure, such interests deserve procedural protections. Thus, the Court must assess whether the procedures and protections afforded Tilton in this Section 225 proceeding create a risk of erroneous deprivation of her interests that could be eliminated by providing her with "additional or substitute procedural safeguards . . . ."[261] I am quite satisfied that the answer to this question is no.

The parties have engaged in extensive discovery and voluminous briefing on myriad issues, including beneficial ownership of the Portfolio Companies' equity.[262] Although the Court originally set three days for trial, the Court extended the trial to six days to give Tilton, and all of the parties, sufficient opportunity to be heard. The

[260] The Court notes "property interests are generally accorded less [due process] protection than are liberty interests." *Commonwealth v. $9,847.00 U.S. Currency*, 704 A.2d 612, 615 (Pa. 1997) (citing *Walters v. Nat'l Ass'n of Radiation Survivors*, 473 U.S. 305 (1985); *Santosky v. Kramer*, 455 U.S. 745 (1982); *May v. Anderson*, 345 U.S. 528 (1953)).

[261] *Cohen*, 89 A.3d at 87 (quoting *Mathews*, 424 U.S. at 335).

[262] Tilton's argument that she was denied due process because she did not have enough time to develop equity ownership evidence is inconsistent with her claim (discussed later in the opinion) that the equity ownership issue was fully developed in the SEC proceeding. *See Tilton*, S.E.C. Release No. 1182. The SEC administrative proceeding was tried well before trial in this matter. *Compare id.* at 1 (indicating that the SEC hearing was held on October 24, 2016 through November 10, 2016), *with* Pl. Zohar Funds' Verified Compl. (filed on November 29, 2016).

Court then heard lengthy post-trial arguments[263] and received additional post-argument submissions relating to the equity ownership issue. These "procedural safeguards" were more than adequate to afford due process.

Moreover, as discussed in detail below, the answers to the key questions raised in this Section 225 dispute lie in the suite of transactional documents that were executed contemporaneously with the Zohar Funds' creation and their respective reinvestment periods. Tilton argues that she needed more time because she wanted to call additional witnesses to testify regarding equity ownership. But no additional testimony would render ambiguous the clear, unambiguous language within the transactional documents at issue here. No additional testimony or other extrinsic evidence would change the fact that Tilton conceded on the witness stand numerous times that no contemporaneous documents support her contention that either she or the Octaluna entities ever received record or beneficial ownership of the disputed shares.[264] And no additional testimony or other extrinsic evidence can change the fact that the Proxies she signed acknowledge that the Zohar Funds own the disputed

[263] Transcript of Post-Trial Oral Argument (D.I. 393) (beginning at 10:03 a.m. and ending at 3:09 p.m.).

[264] *E.g.*, TT 515–517 (Tilton); TT 530:1–12 (Tilton) ("There is no contemporaneous document . . . ."); TT 568:22–569:2 (Tilton) (Q: "is there any contemporaneous document [showing shares] going into Octaluna II? A: No."); TT 579–589 (Tilton) (admitting there is no contemporaneous document showing share ownership going from BNP Paribas to Octaluna or Tilton); TT 604–605 (Tilton) ("There is no contemporaneous document . . . .").

equity.[265] Under these circumstances, I cannot conclude that Tilton has suffered a deprivation of due process.

D. The Zohar Funds Own the Equity in the Portfolio Companies

New York law governs the series of contracts that memorialize the creation and structuring of the Zohar Funds. "Like Delaware, New York follows traditional contract law principles that give great weight to the parties' objective manifestations of their intent in the written language of their agreement."[266] "Thus, a written agreement that is complete, clear and unambiguous on its face must be enforced according to the plain meaning of its terms."[267] "Extrinsic evidence of the parties' intent may be considered only if the agreement is ambiguous, which is an issue of law for the courts to decide."[268]

The parties do not argue that the transactional documents are ambiguous, but do offer starkly different constructions of the relevant provisions. This alone,

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[265] JX 757–61 ("Whereas, Grantor is the owner . . . ."); JX 764–68 ("Whereas, Grantor is the owner . . . ."). Tilton also signed an affidavit attesting that Zohar II owned certain shares of FSAR. JX 1017 (Affidavit of Lost Certificate) at PP225_000011337, ¶¶ 2–3.

[266] *In re IBP, Inc. S'holders Litig.*, 789 A.2d 14, 54 (Del. Ch. 2001); *see also Greenfield v. Philles Records, Inc.*, 780 N.E.2d 166, 170 (N.Y. 2002) ("The fundamental, neutral precept of contract interpretation is that agreements are construed in accord with the parties' intent. The best evidence of what parties to a written agreement intend is what they say in their writing.") (citations omitted) (internal quotation marks omitted).

[267] *Greenfield*, 780 N.E.2d at 170.

[268] *Id.*

however, does not portend ambiguity.[269] "[C]lear contractual language does not become ambiguous simply because the parties to the litigation argue different interpretations."[270] After carefully reviewing the operative agreements, I agree with the parties that they are not ambiguous and must, therefore, be enforced as written.

1. The Transactional Documents Reveal that the Zohar Funds May (And Do) Own Equity in Their Portfolio Companies

The thrust of Tilton's argument as to why she is the beneficial owner of the Portfolio Companies' equity acquired by the Zohar Funds is that Sections 12.1(a)(9) and 7.8(a)(iv)(y) of the Indentures prohibit the Zohar Funds from owning any equity in the Portfolio Companies or otherwise.[271] Those provisions, however, impose no such prohibition.

To begin, Section 12.1(a)(9) has no bearing whatsoever on whether the Zohar Funds may acquire and own equity. Section 12.1(a)(9) provides, in relevant part, that a "Collateral Debt Obligation" is eligible for inclusion in the "Collateral" for the Issuer's secured obligations "as a *Pledged Collateral Debt Obligation*" only if "such Collateral Debt Obligation is not . . . an Equity Security (other than an attached

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[269] *See, e.g.*, *Riverside S. Planning Corp. v. CRP/Extell Riverside, L.P.*, 869 N.Y.S.2d 511, 517 (App. Div. 2008), *aff'd*, 920 N.E.2d 359 (N.Y. 2009).

[270] *Id.*; *see also Consedine v. Portville Cent. Sch. Dist.*, 907 N.E.2d 684, 689 (N.Y. 2009) ("Whether a contract is ambiguous is a question of law . . . .") (citations omitted).

[271] DPTB at 107–14; Def. Lynn Tilton's Post-Trial Reply Br. 34–41.

Equity Kicker . . .).”[272] Section 12.1(a)(9), however, does not prohibit the inclusion of Equity Securities—*as such*—in the Collateral for the Issuer’s secured obligations.[273] To the contrary, the Indentures contemplate that equity may be included in the Collateral as a “Pledged Obligation.”[274] Indeed, “Collateral” necessarily—by definition—includes any and all equity securities in which the Zohar Funds have or acquire an ownership interest.[275] Each Indenture defines the term “Collateral” by reference to the Indenture’s Granting Clauses and the lien

[272] JX 108 (Zohar II Indenture) § 12.1(a)(9) (emphasis supplied); JX 1042 (Zohar III Indenture) § 12.1(a)(9) (same).

[273] As previously discussed, the Indentures define “Equity Securities” to include any “Equity Kicker” and “any other security that does not entitle the holder thereof to receive periodic payments of interest and one or more installments of principal . . . .” JX 108 (Zohar II Indenture) § 1.1 (definition of “Equity Security”); JX 1042 (Zohar III Indenture) § 1.1 (same). An “Equity Kicker” is “[a]ny Equity Security or any other security that is not eligible for purchase by the Issuer but is received with respect to a Collateral Debt Obligation or purchased as part of a ‘unit’ with a Collateral Debt Obligation.” JX 108 (Zohar II Indenture) § 1.1 (definition of “Equity Kicker”); JX 1042 (Zohar III Indenture) § 1.1 (same).

[274] JX 108 (Zohar II Indenture) § 1.1 (defining “Pledged Obligations” as follows: “On any date of determination, (a) the Collateral Debt Obligations, the Unrestricted Collateral Debt Obligations and the Eligible Investments that have been Granted to the Trustee and any Equity Security which forms part of the Collateral and (b) all non-Cash proceeds thereof.”); JX 1042 (Zohar III Indenture) § 1.1 (defining “Pledged Obligations” similarly).

[275] JX 108 (Zohar II Indenture) § 1.1 (defining “Collateral” as “[a]ll Money, instruments, accounts, payment intangibles, general intangibles, letter-of-credit rights, chattel paper, electronic chattel paper, deposit accounts, investment property and other property and rights subject or intended to be subject to the lien of this Indenture for the benefit of the Secured Parties as of any particular time pursuant to the Granting Clauses of th[e] Indenture.”); JX 1042 (Zohar III Indenture) § 1.1 (same).

created thereby.[276] And each of the Indenture's Granting Clauses grant to the indenture trustee—for the benefit of the noteholders and certain other creditors—a continuing lien on "all of Issuer's right, title and interest in . . . all investment property . . . and any and all other property of any type or nature . . . ."[277] This sweeping lien encumbers any equity securities ("investment property") the Funds may acquire over their lifetime.[278] Section 12.1(a)(9) does not exclude equity from the Indentures' lien; nor does it prohibit the Zohar Funds from acquiring and owning equity.[279]

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[276] JX 108 (Zohar II Indenture) § 1.1 (definition of "Collateral"); JX 1042 (Zohar III Indenture) § 1.1 (same).

[277] JX 108 (Zohar II Indenture) at Granting Clauses, § 1.1; JX 1042 (Zohar III Indenture) at Granting Clauses, § 1.1.

[278] The only reasonable construction of the phrase "other property" is that it is a broad catch-all that encompasses equity securities if those securities did not fit within any of the other terms. Even if not given that broad construction, it is reasonable to construe the term "investment property" as including equity securities. *See* U.C.C. § 9-102(a)(49) ("'Investment property' means a security, whether certificated or uncertificated, security entitlement, securities account, commodity contract, or commodity account.").

[279] Nor does the Zohar Funds' beneficial ownership of the Portfolio Companies' equity violate Section 12.1(a)(41) of the Indentures (as Tilton argues). DPTB at 112 (arguing that "[i]f the [Zohar] Funds *were* to own the [Portfolio Companies'] equity, the Funds would . . . own collateral that is not a loan in violation of Section 12.1(a)(41) [of the Indentures] . . . ."). Section 12.1(a)(41) provides that a "Collateral Debt Obligation" is eligible for inclusion in the "Collateral" for the Issuer's secured obligations "*as a Pledged Collateral Debt Obligation*" if "such Collateral Debt Obligation has a Moody's Rating and a Standard & Poor's Rating." JX 108 (Zohar II Indenture) § 12.1(a)(41) (emphasis supplied); JX 1042 (Zohar III Indenture) § 12.1(a)(41). This section neither prohibits the Zohar Funds from acquiring and owning Equity Securities nor does it prohibit the inclusion of Equity Securities in the Collateral as a Pledged Obligation. JX 108 (Zohar II Indenture)

Section 7.8(a)(iv)(y) of the Indentures likewise does not prohibit the Zohar Funds from acquiring and owning equity. This Section provides that the Issuer shall not "permit any lien, charge, adverse claim, security interest, mortgage or other encumbrance (other than the lien of th[e] Indenture) to be created on or extend to or otherwise arise upon or burden the Collateral or any part thereof, any interest therein or the proceeds thereof (except as may be expressly permitted hereby) . . . ."[280]

Here, Tilton argues that the "[Zohar] Funds may not own equity because the tax burdens and other liabilities associated with such equity would operate as a[] . . . 'lien,' 'charge,' or 'encumbrance' 'aris[ing] upon or burden[ing] the Collateral or any part thereof'" in violation of Section 7.8(a)(iv)(y).[281] This argument overlooks that the Zohar Funds' organizational structure operates to insulate them from entity-level tax liability associated with their "beneficial ownership . . . of any Pledged Obligations [*e.g.*, Equity Securities] that secure the[ir] Notes."[282] "For purposes of the [U.S. Tax] Code, each Zohar Fund is to be taxed either as a disregarded entity or

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at Granting Clauses, § 1.1 (defining "Collateral" and "Pledged Obligations"); JX 1042 (Zohar III Indenture) at Granting Clauses, § 1.1 (same).

[280] JX 108 (Zohar II Indenture) § 7.8(a)(iv)(y); JX 1042 (Zohar III Indenture) § 7.8(a)(iv)(y).

[281] DPTB at 111.

[282] JX 108 (Zohar II Indenture) §§ 7.5(c), 1.1 (definition of "Pledged Obligations"); JX 1042 (Zohar III Indenture) §§ 7.5(c), 1.1 (same).

as a partnership."[283] And "*solely* for [U.S.] federal, state and local tax purposes," each Zohar Fund's preference shareholder is treated as owning that Fund's assets directly.[284]

Ultimately, then, the Zohar Funds do not bear the tax burdens associated with their beneficial ownership of equity securities.[285] Insofar as the Zohar Funds earn income on account of their beneficial ownership of equity securities, that income is taxable to the Funds' preference shareholders—Octaluna II and Octaluna III—*not* to the Funds themselves.[286] That being so, Section 7.8(a)(iv)(y) of the Indentures does not prohibit the Zohar Funds from acquiring and owning equity. This construction is entirely consistent with the design of the Zohar Funds because it accounts for the fact that even though the Funds could own equity as a matter of state property law, they also had to incorporate the tax protection the rating agencies required with respect to that equity.

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[283] JX 112 (Zohar II Arts. of Ass'n, sched. X, § 1(a)); JX 1040 (Zohar III Arts. of Ass'n, sched. X, § 1(a)).

[284] JX 112 (Zohar II Arts. of Ass'n, sched. X § 1(a)) (emphasis supplied); JX 1040 (Zohar III Arts. of Ass'n, sched. X, § 1(a)) (same).

[285] *See, e.g.*, TT 994:6–13, 997:10–20, 998:2–17, 1058:16–1059:3 (Bowden); TT 1373:3–1375:20 (Peaslee).

[286] *See* JX 112 (Zohar II Arts. of Ass'n, sched. X, § 1(a)); JX 1040 (Zohar III Arts. of Ass'n, sched. X, § 1(a)); TT 994:6–13, 997:10–20, 998:2–17, 1058:16–1059:3 (Bowden), 1373:3–1375:20 (Peaslee).

Tilton cites her (indirect) tax ownership of the Zohar Funds (via Octaluna II and Octaluna III) to bolster her claim that she "ultimately and beneficially own[s]" the equity of the Zohar Funds' portfolio companies.[287] Of course, tax ownership does not dictate state property law ownership, as the tax experts recognized.[288] Here, the Octaluna entities' tax ownership of the Zohar Funds serves a practical function; namely, insulating the Funds from potential U.S. tax liability.[289] With these structural imperatives in mind, Tilton's indirect tax ownership of the Zohar Funds does not support her beneficial ownership claim. Nor does it create a scenario where Tilton would be saddled with liability with no upside; indeed, the upside under the waterfall for the preference shareholders was potentially substantial if the Zohar Funds performed as anticipated.[290]

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[287] DPTB at 106, 108–10.

[288] TT 1382–1385, 1395 (Peaslee); TT 1529–1530 (T. Humphreys); TT 1058:3–15 (Bowden); *see also United States v. Nat'l Bank of Commerce*, 472 U.S. 713, 722 (1985) ("'[I]n the application of a federal revenue act, state law controls in determining the nature of the legal interest which the taxpayer had in the property.' [citations omitted]. This follows from the fact that the federal statute 'creates no property rights but merely attaches consequences, federally defined, to rights created under state law.' [citation omitted].").

[289] TT 1373:3–1375:20 (Peaslee).

[290] *See, e.g.*, JX 108 (Zohar II Indenture) §§ 11.1(a)(i)(M), (a)(ii)(J), 11.2(a)(xi), 12.2(d); JX 1042 (Zohar III Indenture) §§ 11.1(a)(i)(Q), (a)(ii)(I), 12.2(c).

Although the Indentures prohibit the Zohar Funds from purchasing Equity Securities in some circumstances, they do not prohibit the Zohar Funds from acquiring "Equity Kickers."[291] Nor do the Indentures prohibit the Zohar Funds from acquiring Equity Securities "in connection with a workout or restructuring of an Obligor [on a Collateral Debt Obligation], its Affiliates, or the lines of business of the Obligor, or its Affiliates."[292] It follows, therefore, that the Indentures do not outright prohibit the Zohar Funds from acquiring (and owning) Equity Securities.

Tilton argues that the Equity Securities held by the Zohar Funds were acquired "alongside" Collateral Debt Obligations, and thus are neither Equity Kickers nor Equity Workout Securities.[293] According to Tilton, an Equity Security is not an Equity Kicker (nor an Equity Workout Security) unless the Obligor on the Collateral Debt Obligation issued (or transferred) that equity as a term of the underlying loan

[291] JX 108 (Zohar II Indenture) § 1.1 (definition of "Equity Kicker"); JX 1042 (Zohar III Indenture) § 1.1 (same).

[292] *See* JX 108 (Zohar II Indenture) § 1.1 (definition of "Equity Securities"); JX 1042 (Zohar III Indenture) § 1.1 (same); *see also* JX 108 (Zohar II Indenture) §§ 7.12, 12.1(a)(9); JX 1042 (Zohar III Indenture) §§ 7.12, 12.1(a)(9). As noted, the Zohar III Indenture does not use the term "Equity Workout Security"; that term is subsumed within the definition of "Equity Security." Thus, I use the term "Equity Workout Security" to refer an "Equity Security" (as defined in the Zohar III Indenture) received by either of the Zohar Funds "in connection with a workout or restructuring of an Obligor [of a Collateral Debt Obligation]." JX 108 (Zohar II Indenture) § 1.1 (definition of "Equity Security").

[293] DPTB at 52–56.

obligation.[294] Tilton's position, however, is inconsistent with the Indentures' use of disjunctive language ("or") in the definitions of Equity Kickers and Equity Workout Securities.[295] For example, the Zohar III Indenture defines an "Equity Kicker" as "[a]ny Equity Security or any other security that is . . . received with respect to a Collateral Debt Obligation **or** purchased as part of a 'unit' with a [Collateral Debt Obligation]."[296] This language clearly reflects that an Equity Kicker can be *either* an Equity Security "received with respect to a Collateral Debt Obligation" *or* an Equity Security "purchased as part of a unit with a [Collateral Debt Obligation]." Both elements are not required; either element suffices to meet the definition of Equity Kicker.

Every contemporaneous transactional document shows that the equity in the Portfolio Companies at issue here is either an Equity Kicker or Equity Workout Security. Specifically, as discussed below, the equity was either "received [by the

[294] *Id.* at 52–56.

[295] *See* JX 108 (Zohar II Indenture) § 1.1 (definition of "Equity Kicker"); JX 1042 (Zohar III Indenture) § 1.1 (same); JX 108 (Zohar II Indenture) § 1.1 (definition of "Equity Workout Security").

[296] JX 1042 (Zohar III Indenture) § 1.1 (emphasis supplied); *see also* JX 108 (Zohar II Indenture) § 1.1 (An "Equity Workout Security" is "[a]ny security received in exchange for **or** in connection with a Collateral Debt Obligation or Unrestricted Collateral Debt Obligation, which security does not entitle the holder thereof to receive periodic payments of interest and one or more installments of principal.") (emphasis supplied).

Zohar Funds] with respect to a Collateral Debt Obligation,"[297] "purchased [by the Zohar Funds] as part of a 'unit' with a Collateral Debt Obligation" or acquired by the Zohar Funds "in connection with a workout or restructuring of an Obligor [on a Collateral Debt Obligation]."[298]

Turning first to the Zohar II-OFSI Transfer, in which Zohar II acquired FSAR equity, the LSTA Agreement that documents this transfer provides that Zohar II acquired "all of [OFSI's] right, title and interest in" (1) a revolving loan and two term loans to Electro Source with a total commitment value of $18,942,000; and (2) 410 shares of FSAR common stock.[299] The 410 shares of FSAR common stock are Equity Kickers because they were "received [by Zohar II] with respect to a Collateral Debt Obligation"—the three Electro Source loan obligations (or each of them)—or otherwise were "purchased [by Zohar II] as part of a 'unit' with [such] Collateral Debt Obligation[(s)]."[300]

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[297] JX 108 (Zohar II Indenture) § 1.1; JX 1042 (Zohar III Indenture) § 1.1.

[298] JX 108 (Zohar II Indenture) § 1.1; JX 1042 (Zohar III Indenture) § 1.1.

[299] JX 135 at 7; *see also id.* at 1–3.

[300] JX 108 (Zohar II Indenture) § 1.1; JX 1042 (Zohar III Indenture) § 1.1; *see also* JX 135 at 7 (stating that "'Equity' means 410 shares of Common Stock issued by [FSAR] Holdings to [OFSI]" and that "'Transferred Rights' means any and all of [OFSI's] right, title and interest in, to and under (i) the Loans [to Electro Source] and the Commitments (if any) and (ii) the Equity . . . .").

As for the Zohar II-BNP Paribas Transfer, in which Zohar II acquired Glenoit equity, here again the LSTA Agreement memorializing this transfer provides that Zohar II acquired "all of [BNP Paribas's] right, title and interest in" (1) a Glenoit LLC term loan commitment of $5,378,633.22; (2) 78,561 Class A shares of Glenoit common stock; and (3) 21,369 Class B shares of Glenoit common stock.[301] The 78,561 Class A and 21,369 Class B shares of Glenoit common stock are Equity Kickers because they were "received [by Zohar II] with respect to a Collateral Debt Obligation"—the $5,378,633.22 Glenoit LLC term loan commitment—or otherwise were "purchased [by Zohar II] as part of a 'unit' with [that] Collateral Debt Obligation."[302]

Next is the Zohar II-Deutsche Bank Transfer, in which Zohar II acquired additional Glenoit equity. The LSTA Agreement memorializing this transfer reflects that Zohar II acquired "all of [Deutsche Bank's] right, title and interest in" (1) a Glenoit LLC term loan commitment of $3,502,279.77; (2) 57,448 Class A shares of

[301] JX 152 at 1–3, 7–8.

[302] JX 108 (Zohar II Indenture) § 1.1; JX 1042 (Zohar III Indenture) § 1.1; JX 152 at 7 (stating that "'Shares' means, collectively, 78,561 shares of Class A Common Stock of [Glenoit], par value $0.01 per share, and 21,369 shares of Class B Common Stock of [Glenoit]," and that "'Transferred Rights' means any and all of Seller's right, title, and interest in, to and under the Loans [to Glenoit LLC], the Commitments [to Glenoit LLC] (if any), and the Shares . . . .").

Glenoit common stock; and (3) 15,626 Class B shares of Glenoit common stock.[303] The 57,448 Class A and 15,626 Class B shares of Glenoit common stock are Equity Kickers because they were "received [by Zohar II] with respect to a Collateral Debt Obligation"—the $3,502,279.77 Glenoit LLC term loan commitment—or otherwise were "purchased [by Zohar II] as part of a 'unit' with [that] Collateral Debt Obligation."[304]

The fourth transaction is the UI Restructuring, in which the Zohar Funds acquired UI equity. This transaction is evidenced by a "Sale, Settlement, and Release Agreement,"[305] which reveals that Zohar II received 54.9604 Class A and 2.8663 Class B shares of UI; and Zohar III received 30.3621 Class A and 1.5834 Class B shares of UI.[306] These shares of UI stock are Equity Workout Securities because the Zohar Funds received them "in connection with a . . . restructuring of an Obligor [on a Collateral Debt Obligation]," namely, the restructuring of UI.[307]

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[303] JX 184 at 1–3, 7–8; JX 587 (Glenoit stock certificates).

[304] JX 108 (Zohar II Indenture) § 1.1; JX 1042 (Zohar III Indenture) § 1.1; *see also* JX 184 at 1 ("Commitments" and "Loans" both refer to the "Term Loan [to Glenoit LLC] in the principal amount of $3,502,279.77"); JX 184 at 7 ("'Transferred Rights' means any and all of [Deutsche Bank's] right, title, and interest in, to and under the Shares [and] the Loans and the Commitments . . . ."); JX 184 at 8 ("'Shares' means 57,448 Class A Common Shares of [Glenoit] and 15,626 Class B Common Shares of [Glenoit].").

[305] JX 374.

[306] JX 374 at S-2.

[307] JX 108 (Zohar II Indenture) § 1.1; JX 1042 (Zohar III Indenture) § 1.1; *see also* JX 374. As noted, prior to the UI Restructuring, the Zohar Funds had participated in a syndicated

In the Zohar III-Platinum Grove Transfer, Zohar III acquired additional UI equity. This transfer is memorialized in an LSTA Agreement,[308] which reflects that Zohar III acquired (1) a UI term loan with an outstanding principal amount of $6,435,588.98; (2) 21.8674 Class A shares of UI; and (3) 1.1404 Class B shares of UI.[309] The 21.8674 Class A shares and 1.1404 Class B shares of UI are Equity Kickers because they were "received [by Zohar III] with respect to a Collateral Debt Obligation"—the UI term loan—or otherwise were "purchased [by Zohar III] as part of a 'unit' with [that] Collateral Debt Obligation."[310]

Last is the Zohar II-Ark I Transfer, in which Zohar II acquired shares of FSAR and Glenoit. For this acquisition, it is necessary to look to several documents in order to see the full picture of the transaction. The transfer is memorialized in an

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loan to UI. JX 374 at 1. In the UI Restructuring, the Zohar Funds and other UI lenders (1) waived a prior covenant default and extended the loan's maturity by two years and made another $10 million loan to UI; and (2) received 100% of UI's stock, subject to a warrant of the existing owner of UI's equity to acquire a 30% economic interest in UI. *Id.* at 1–3.

[308] JX 473.

[309] JX 473 at 1–3, 6.

[310] JX 108 (Zohar II Indenture) § 1.1; JX 1042 (Zohar III Indenture) § 1.1; *see* JX 473 at 3 ("'Loans' means Term Loans of Tranche TLB in the outstanding principal amount of $6,435,588.98."); JX 473 at 6 ("[Zohar III's] obligations to pay the Purchase Price [to Platinum Grove and] to acquire the Transferred Rights . . . shall be subject to the additional condition that [Platinum Grove] has completed the transfer to [Zohar III] . . . for no additional consideration . . . of 21.8674 shares of [UI's] Class A Voting Common Stock and 1.1404 shares of [UI's] Class B Non-Voting Common Stock . . . .").

"Issuer Collateral Debt Obligations Transfer Agreement."[311] Although that agreement is not ambiguous, it is not fully integrated in that it does not specify the names of all loan obligors whose equity was transferred to Zohar II in the transaction. The Zohar II Indenture provides this information, but it omits FSAR's name for confidentiality reasons and, instead, refers to FSAR as "B6." Glenoit is identified as "B12."[312]

The Issuer Agreement provides that Zohar II acquired, *inter alia*, "any and all of [Ark I's] right, title and interest in" (1) a $5,878,066.95 Glenoit obligation; (2) a $11.21 million Electro Source obligation; (3) 74,033 Class A shares of Glenoit common stock; (4) 20,137 Class B shares of Glenoit common stock; and (5) 590 shares of FSAR common stock.[313] The 74,033 Class A and 20,137 Class B shares of Glenoit are Equity Kickers because they were "received [by Zohar II] with respect to a Collateral Debt Obligation"—the $5,878,066.95 Glenoit obligation—or otherwise were "purchased [by Zohar II] as part of a 'unit' with [that] Collateral

[311] JX 120 (Issuer Agreement).

[312] JX 108 (Zohar II Indenture), sched. A-2. While the parties do not appear to dispute that B6 is FSAR and B12 is Glenoit, the record confirms that anonymous references and corresponding identities. JX 120 (Issuer Agreement), sched. 1; JX 108 (Zohar II Indenture), sched. A-2; JX 1017 (Affidavit of Lost Certificate) at PP225_000011337, ¶¶ 2–3.

[313] JX 120 (Issuer Agreement) at 7; *see also id.* at 4, 5-8, sched. 1; JX 108 (Zohar II Indenture), sched. A-2.

Debt Obligation."[314] Likewise, the 590 shares of FSAR common stock are Equity Kickers because they were "received [by Zohar II] with respect to a Collateral Debt Obligation"—the $11.21 million Electro Source obligation—or otherwise were "purchased [by Zohar II] as part of a 'unit' with [that] Collateral Debt Obligation."[315]

The transactional documents discussed above clearly show that the Zohar Funds acquired the Portfolio Companies' equity. Tilton has no documentary or other admissible evidence to counter these contemporaneous deal documents. In fact, she has acknowledged the Zohar Funds' ownership in several documents she herself has executed.[316]

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[314] JX 108 (Zohar II Indenture) § 1.1; JX 1042 (Zohar III Indenture) § 1.1; *see* JX 120 (Issuer Agreement) at Recitals, §§ 1(o)(i)–(ix), 2, sched. 1.

[315] JX 108 (Zohar II Indenture) § 1.1; JX 1042 (Zohar III Indenture) § 1.1.

[316] Tilton executed an affidavit on January 20, 2006, in which she attested that the certificate for the 590 FSAR shares was lost and requested a replacement. JX 1017 (Affidavit of Lost Certificate) at PP225_00001137, ¶¶ 2–3. In that affidavit, she swore under oath that "pursuant to an Issuer Collateral Debt Obligations Transfer Agreement dated as of January 14, 2005, [Ark I] has sold, assigned and transferred the [certificate for those 590 FSAR common shares] to Zohar II 2005-1, Limited." *Id.* And then she again acknowledged the Zohar Funds' ownership of the equity in the Proxies at issue here. *See* JX 757–761, 764–768. I point this out not to suggest that extrinsic evidence is necessary to discern the parties' intent as expressed in the contemporaneous deal documents. The agreements are unambiguous so extrinsic evidence is neither required nor admissible. *See, e.g.*, *Greenfield*, 780 N.E.2d at 170–71. But Tilton's admission that the Zohar Funds own this equity, provided on a clear day in her own hand, does, however, make her litigation position here, and the sworn testimony offered to support it, less credible.

2. Tilton is not the Beneficial Owner of the Equity

Tilton's hindsight observations regarding what the parties intended, and her revisionist view of what the contemporaneous documents say, cannot compete with the clear and unambiguous terms of the agreements that she negotiated on behalf of her various entities and ultimately executed to seal the deal(s). Apparently appreciating this reality, she urges the Court to consider a slew of extrinsic evidence that allegedly shows her Octaluna entities acquired beneficial ownership of the disputed stock.[317] Having found the operative contracts to be unambiguous,

[317] Tilton suggests that the Court should consider, *inter alia*, internal MBIA memos and other items that allegedly show that MBIA agreed that she should own the equity of the portfolio companies because she bore the tax burden for the Zohar funds. *See, e.g.*, JX 91; JX 431; JX 774; JX 796. She also offers testimony to the effect that everyone involved in the creation of the Zohar funds understood that Tilton would own the equity, and would control the funds and their portfolio companies, in consideration of the fact she ultimately would bear the tax liability. *See, e.g.*, TT 713:20–714:1 (Tilton); TT 1468:12–19 (McKiernan). This is extrinsic evidence, and the law forbids the Court from using it to construe unambiguous written agreements. *Greenfield*, 780 N.E.2d at 170–71. If I were to consider extrinsic evidence, I would, of course, also have to consider the clear terms of the Proxies that are at the heart of Tilton's legal defense. Those grants (signed by Tilton) state that the Zohar Funds own the disputed equity. *See, e.g.*, JX 764–66. Indeed, it is that acknowledgement that created the need for the Proxies in the first place as a means to perpetuate Tilton's control over the Portfolio Companies. There are numerous other documents, including others signed by Tilton, which show the Zohar Funds own the disputed equity. *E.g.*, JX 144 (FSAR stock certificates); JX 762 (written consent signed by Tilton indicating that Zohar II is a Glenoit "Stockholder"); JX 1017 (Affidavit of Lost Certificate) at PP225_000011337, ¶¶ 2–3; JX 561 (Zohar II Document Transmittal Form) at PP-DEL2-000404874 (showing transmittal of FSAR stock as collateral to the Zohar II trustee for custody). Tilton's attempts to explain this evidence away are not credible. Her argument regarding her alleged "gift" of equity upside to the Zohar Funds is likewise not credible, particularly because her argument is based on extrinsic testimonial evidence and not supported by a single contemporaneous document evidencing such a conveyance. *See, e.g.*, TT 615:16–626:17 (Tilton).

however, Tilton's parol evidence is inadmissible.[318] This strict application of the parol evidence rule is especially fitting here. Tilton is very sophisticated; indeed, she is the architect of the Zohar Funds and others like them.[319] Accordingly, the rule that the Court must enforce the terms these parties bargained for applies with "even greater force."[320]

In reaching the conclusion that the Zohar Funds own the equity at issue, I am satisfied that the interests of the non-party Octaluna entities were adequately represented by Tilton. Indeed, Tilton has advanced those interests vigorously throughout this litigation.[321]

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[318] *Greenfield*, 780 N.E.2d at 170–71 ("Extrinsic evidence of the parties' intent may be considered only if the agreement is ambiguous, which is an issue of law for the courts to decide. . . . [I]f the agreement on its face is reasonably susceptible of only one meaning, a court is not free to alter the contract to reflect its personal notions of fairness and equity.") (citations omitted).

[319] *See, e.g.*, TT 844:20–23, 868:24–869:3 (Tilton) ("[Ark I] was a first-of-a-kind deal . . . [because] all the notes in this deal built on distressed assets would be rated investment grade. . . . [Ark I] served as a template for the structure [of the Zohar Funds.] As the [Zohar] strategy evolved, there were slight changes, but Ark I was definitely the template.").

[320] *Progressive Int'l Corp. v. E.I. Du Pont de Nemours & Co.*, 2002 WL 1558382, at *7 (Del. Ch. July 9, 2002) ("This presumption that parties will be bound by the language of the contracts they negotiate holds even greater force when, as here, the parties are sophisticated entities that bargained at arm's length."); *see also Oppenheimer & Co. v. Oppenheim, Appel, Dixon & Co.*, 660 N.E.2d 415, 421 (N.Y. 1995) ("Freedom of contract prevails in an arm's length transaction between sophisticated parties such as these, and in the absence of countervailing public policy concerns there is no reason to relieve them of the consequences of their bargain.").

[321] In keeping with the Supreme Court's guidance, I find that Tilton adequately represented the Octaluna entities and they had an opportunity to be heard through Tilton, their "sole

3. The SEC Proceedings and Collateral Estoppel

While the parties litigated this Section 225 action, the SEC pursued an administrative enforcement action against Tilton and several of her Patriarch

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owner" and the person who served as Managing Member. *See Genger*, 26 A.3d at 202–03 (noting that an absent party may consent to be represented "by an authorized representative"); DPTB at 32 nn.11–12; JX 106 at 22; TT 698:5–8 (Tilton) ("[A]s Octaluna, I own all of this . . . ."); TT 1307:8–11 (Tilton) ("I am still the managing member of Octaluna."). This finding is also consistent with the Restatement (Second) Judgments, which is regularly followed by Delaware courts. *See* Restatement (Second) Judgments § 41 (1982) ("(1) A person who is not a party to an action but who is represented by a party is bound by and entitled to the benefits of a judgment as though he were a party. A person is represented by a party who is: (b) Invested by the person with authority to represent him in an action; or (c) The executor, administrator, guardian, conservator, or similar fiduciary manager of an interest of which the person is a beneficiary"); *Pyott v. La. Mun. Police Empls.' Ret. Sys.*, 74 A.3d 612, 618 & n.21 (Del. 2013) (citing Restatement (Second) Judgments); *Household Int'l, Inc. v. Eljer Indus., Inc.*, 1993 WL 133065, at *2 n.4 (Del. Ch. Apr. 22, 1993) (Allen, C.) (same). Indeed, as noted many times in this Opinion, Tilton has argued that she is the beneficial owner of the equity at issue here through the Octaluna entities from the beginning of this dispute through to its conclusion. Tilton's Countercl. ¶¶ 1, 15–21, 46, 49, 57–60, 80–92; *id.* ¶ E (Prayer for Relief); DPTB at 108–20; *see also* TT 698:5–8 (Tilton) (maintaining that she owns the equity through her Octaluna entities).

I note that the Court's determination that the Octaluna entities have been adequately represented here is in no way inconsistent with the Court's holding that the separateness of Tilton's entities must be observed in connection with the application of Section 212(e). The Court's "coupling" ruling (with respect to the Proxies) was a matter of statutory interpretation. *See Zambrana*, 118 A.3d at 775 ("'Where the intent of the legislature is clearly reflected by unambiguous language in the statute, the language itself controls.'") (quoting *Spielberg*, 558 A.2d at 293). By contrast, the issue here is one of a judgment's binding effect on non-parties and adequate representation, as established by Delaware's decisional law and the Restatement (Second) of Judgments §§ 41, 62. *See Genger*, 26 A.3d at 201 ("[E]ntities, through their authorized representatives, [are] legally empowered to give [their consent]."); *see also Kohls v. Kenetech Corp.*, 791 A.2d 763, 769 (Del. Ch. 2000) ("[W]here a non-party has a specific type of pre-existing legal relationship with a named party, such as bailor and bailee, predecessor and successor or indemnitor and indemnitee, the non-party can be bound."). These two issues involve different paradigms and are governed by separate legal doctrines.

affiliates for allegedly violating the Investment Advisors Act of 1940 and the Investment Company Act of 1940 in connection with the three Zohar funds' operations.[322] The SEC's principal allegations were that (1) Tilton improperly categorized and overvalued loans in a way that misled the Zohar funds' investors and allowed Tilton to collect unearned management fees, and (2) the Zohar funds' "financial statements [provided to the trustees and noteholders] were false and misleading and did not comply with GAAP, in respect to impairment and fair valuing of assets."[323]

Well after post-trial argument, Tilton supplemented the record *sub judice* with the Initial Decision of the assigned SEC administrative law judge ("ALJ"), in which the ALJ determined that the SEC did not carry its burden of proof as to its claim that Tilton had misled or defrauded the Zohar funds' investors.[324] Tilton argues that the

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[322] *Tilton*, S.E.C. Release No. 1182. Specifically, the SEC brought an Order Instituting Proceedings against Tilton and her affiliates under Sections 203(e), 203(f) and 203(k) of the Investment Advisors Act and Section 9(b) of the Investment Company Act. *Id.* at 1–2. The specific Patriarch affiliates involved in the SEC proceeding were Patriarch, Patriarch Partners VIII, Patriarch Partners XIV and Patriarch Partners XV. *Id.* at 1.

[323] *Id.* at 48.

[324] *Id.* at 53 (regarding categorization of assets, "[t]he total mix of information available to the investors was such that there was no omission to state a material fact or misrepresentation of a material fact."); *id.* at 56 ("The financial statements disclosed the subjective and uncertain nature of the fair valuation techniques, and in light of the Division's burden of proof, it is concluded that violation of GAAP is unproven with reference to fair value.").

ALJ found that the Zohar funds did not own equity in their portfolio companies, and that collateral estoppel bars the Zohar Funds from arguing in these proceedings that they own the disputed equity in FSAR, Glenoit and UI. For reasons discussed below, her argument fails both procedurally and substantively.

Tilton argued in her first letter to the Court that the Initial Decision "destroys the foundation of [the Zohar Funds'] claims here."[325] In support of this forceful statement, she pointed to the following excerpt from the decision: "*for the purpose of this administrative proceeding*, the Zohar Funds, beyond their right to receive interest and principal payments on loans or other assets listed in the Trustee Reports, had no express equity ownership or beneficial rights in the Portfolio Companies."[326] Tilton raised her collateral estoppel argument later in the flurry of correspondence submitted by the parties in reaction to the Initial Decision, seemingly as an afterthought.[327] Tilton having raised the issue, the Zohar Funds then dutifully responded to the merits of the collateral estoppel argument in a sur-reply. Tilton

[325] Letter to Vice Chancellor Joseph R. Slights III, at 3 (Sept. 28, 2017).

[326] *Tilton*, S.E.C. Release No. 1182, at 25 (emphasis supplied).

[327] D.I. 433–39. I say that Tilton raised the argument as an afterthought because the argument did not appear until her reply letter, and the most she said was that collateral estoppel "may" apply to the findings in the Initial Decision relating to equity ownership. Letter to Vice Chancellor Joseph R. Slights III, at 5–6 (Oct. 3, 2017) ("[D]octrines of collateral estoppel and *res judicata* may well apply to Judge Foelak's factual findings. [String cite omitted]. At the very least, though, the SEC decision is unquestionably persuasive authority . . . .").

then submitted a sur-sur-reply in which she rehashed old arguments and then criticized the Zohar Funds for filing an "unauthorized sur-reply submission," as if any of the submissions had been solicited or "authorized."[328]

Tilton did not properly raise her collateral estoppel argument. Her first submission alerting the Court to the Initial Decision said nothing of collateral estoppel. Indeed, she did not definitively raise the argument until her sur-sur-reply. In any event, even if properly raised, Tilton's collateral estoppel argument fails on the merits. In this regard, the Court must apply the law of the jurisdiction that rendered the purported preclusive decision.[329] In this case, a federal administrative agency (the SEC) rendered the Initial Decision, and SEC decisions are subject to review by federal courts of appeal.[330] Thus, I apply the generally accepted rules of

[328] Letter to Vice Chancellor Joseph R. Slights III, at 1 (Oct. 6, 2017).

[329] *See Pyott*, 74 A.3d at 615–16 (describing choice-of-law rules in the context of collateral estoppel); Restatement (Second) Conflict of Laws § 95 (1971) ("What issues are determined by a valid judgment is determined, subject to constitutional limitations, by the local law of the State where the judgment was rendered."); § 95 cmt. h (Supp. 1989) ("*Federal judgments*. Federal law determines the effects under the rules of res judicata of a judgment of a federal court.").

[330] 15 U.S.C. § 80b-13(a) (providing that "[a]ny person or party aggrieved by an order issued by the Commission under [the Investment Advisers Act] may obtain a review of such order in the United States court of appeals within any circuit wherein such person resides or has his principal office or place of business, or in the United States Court of Appeals for the District of Columbia").

collateral estoppel established by the U.S. Supreme Court and the federal courts of appeal.

Under the federal law of issue preclusion, "once an issue is actually and necessarily determined by a [tribunal] of competent jurisdiction,"[331] that determination "may preclude relitigation of the issue in a [subsequent suit] on a different cause of action involving a party to the first case."[332] Issue preclusion extends to factual issues actually and necessarily determined in an administrative adjudication if the party opposing preclusion "had an adequate opportunity to litigate" those issues.[333] Issue preclusion does not apply, however, "when the party against whom the earlier decision is asserted did not have a 'full and fair opportunity' to litigate th[e] [relevant] issue[s] in the earlier case."[334]

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[331] *Montana v. United States*, 440 U.S. 147, 153 (1979).

[332] *Allen v. McCurry*, 449 U.S. 90, 94 (1980); *see also Bobby v. Bies*, 556 U.S. 825, 834 (2009) ("Issue preclusion bars successive litigation of 'an issue of fact or law' that 'is actually litigated and determined by a valid and final judgment, and . . . is essential to the judgment.' Restatement (Second) of Judgments § 27 (1980). If a judgment does not depend on a given determination, relitigation of that determination is not precluded.").

[333] *United States v. Utah Constr. & Min. Co.*, 384 U.S. 394, 422 (1966); *see also Kremer v. Chem. Constr. Corp.*, 456 U.S. 461, 484 n.26 (1982) ("In [*Utah Construction*], we held that, so long as opposing parties had an adequate opportunity to litigate disputed issues of fact, res judicata is properly applied to decisions of an administrative agency acting in a 'judicial capacity.'") (quoting *Utah Constr.*, 384 U.S. at 422); *Montana*, 440 U.S. at 153 (holding that a finding is given preclusive effect only if it is "actually and necessarily determined by a court of competent jurisdiction").

[334] *Allen*, 449 U.S. at 95 (quoting *Montana*, 440 U.S. at 153).

The ALJ's Initial Decision does not have issue preclusive effect in this Section 225 action for two independent reasons. *First*, the issues decided there are not at issue here, and vice versa. For reasons explained at length above, the Court has found it necessary to decide in this case whether the Zohar Funds are beneficial owners of equity in the Portfolio Companies. The ALJ's Initial Decision, on the other hand, did not turn on whether the Zohar Funds own equity in their portfolio companies.[335] That decision addresses (and dismisses) the SEC's charges against Tilton and her Patriarch entities for allegedly violating federal antifraud laws.[336] Specifically, as noted above, the issues joined for decision were (1) whether "Tilton improperly categorized and overvalued loans" owned by the Zohar Funds,[337] and if so, whether such mis-categorization and overvaluation was disclosed to the Zohar noteholders; and (2) whether "the [Zohar] Funds' financial statements were false and misleading and did not comply with GAAP, in respect to impairment and fair valuing of assets."[338]

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[335] *See Tilton*, S.E.C. Release No. 1182, at 2, 47–48; *Bobby*, 556 U.S. at 834 ("If a judgment does not depend on a given determination, relitigation of that determination is not precluded.") (citation omitted).

[336] *See Tilton*, S.E.C. Release No. 1182, at 47–57.

[337] *Id.* at 47.

[338] *Id.* at 48.

The ALJ's dismissal decision was not dependent on whether the Zohar Funds own equity in their portfolio companies. Rather, the SEC and the ALJ were primarily concerned with whether Tilton misled investors by making the Zohar funds' loans appear more valuable than they actually were.[339] The ALJ devoted much of the Initial Decision to analyzing whether Tilton improperly placed the Zohar funds' respective loans in higher-value categories when performing necessary ratio tests in an effort to secure collateral manager fees and (potentially) a return on the preference shares.[340] In that regard, the Initial Decision determined that even if Tilton's "asset categorizations and consequent OC Ratio computations were not in

[339] *See id.* at 52–53 (Tilton's approach to categorizing loans owned by the Zohar Funds "was disclosed [to Zohar investors] in the trustee reports . . . . The total mix of information available to the investors was such that there was no omission . . . or misrepresentation of a material fact."); *id.* at 56 (Tilton's "treatment of impairment or fair value on the [Zohar Funds'] financial statements . . . did not alter the total mix of information available to Zohar investors in light of the more comprehensive information in the trustee reports, so that [any] misrepresentation or omission was not material . . . .").

[340] Tilton, through her Patriarch affiliates, categorized the Zohar funds' loans as part of an "overcollateralization ratio test," or "OC Ratio Test." JX 51 (Zohar I Indenture) § 1.1; JX 108 (Zohar II Indenture) § 1.1; JX 1042 (Zohar III Indenture) § 1.1; *see also Tilton,* S.E.C. Release No. 1182, at 16. In the OC Ratio Test, the numerator is the collateral balance or "carrying value" plus cash. *E.g., Tilton,* S.E.C. Release No. 1182, at 16. The denominator is the outstanding principal balance of the notes due to the funds' investors. *Id.* By manipulating the value of the loans (i.e., categorize a defaulted loan as a valuable loan), one could obtain a "passing" ratio. *Id.* The Patriarch Managers' ability to collect management fees and the preference shareholders' ability to receive a distribution were dependent on the Zohar funds "passing" the OC Ratio Test. *Id.* at 17.

accord with the provisions of the [Zohar funds'] indentures, this disparity was disclosed to the investors."[341]

The ALJ devoted the balance of the Initial Decision to discussing whether certain financial statements and reports complied with GAAP.[342] Thus, it is not surprising that the Initial Decision mentions the word "equity" only once in its lengthy Conclusions of Law.[343] Insofar as the Initial Decision considered whether the Zohar Funds own equity in their portfolio companies, that issue—equity ownership—was not case-dispositive.[344] Accordingly, the ALJ's equity ownership "finding" does not have issue preclusive effect with respect to the Court's determination of equity ownership here.[345]

Second, even if the Initial Decision turned on whether the Zohar Funds own equity in their portfolio companies, the ALJ's determination of that issue still would

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[341] *Id.* at 52.

[342] *Id.* at 53–57.

[343] *Id.* at 55 (referencing "equity" generally in discussing what makes a debt restructuring a "troubled debt restructuring").

[344] *Bobby*, 556 U.S. at 834 ("A determination ranks as necessary or essential only when the final outcome hinges on it."). In fact, the ALJ's equity ownership finding was expressly case-specific. *Tilton*, S.E.C. Release No. 1182, at 25 (limiting that Finding to "this administrative proceeding"). Moreover, the ALJ expressed skepticism before making the purported preclusive finding. *Id.* ("[Tilton] testified that she 'gifted' the equity upside to the [Zohar] Funds. [Record cites omitted]. However, there are no deeds of gift or other documents in evidence effectuating such gifts.").

[345] *See Montana*, 440 U.S. at 153; *Bobby*, 556 U.S. at 834.

not have issue preclusive effect here because the Zohar Funds were not parties to the SEC proceeding.[346] Issue preclusion does not apply "when the party against whom the earlier decision is asserted did not have a 'full and fair opportunity' to litigate th[e] [relevant] issue[s] in the earlier case."[347] Here, Tilton seeks to bind the Zohar Funds to the Initial Decision when neither Fund had a "full and fair opportunity" to litigate the issue of equity ownership before the ALJ. Nor were the Zohar Funds in "privity" with the SEC such that the SEC should be deemed to have adequately presented the Funds' positions and protected their interests with respect to their equity ownership in the Portfolio Companies, either as a matter of substantive preclusion law[348] or due process.[349]

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[346] *See Tilton*, S.E.C. Release No. 1182, at 1.

[347] *Allen*, 449 U.S. at 95 (quoting *Montana*, 440 U.S. at 153).

[348] The term "privity" refers to "substantive legal relationships between the person to be bound and a party to the judgment." *Taylor v. Sturgell*, 553 U.S. 880, 894 & n.8 (2008) (alterations and internal quotations omitted). "Qualifying relationships include, but are not limited to, preceding and succeeding owners of property, bailee and bailor, and assignee and assignor." *Id.* at 894.

[349] As noted above, due process demands, at a minimum, notice and a meaningful opportunity to be heard. *See Eldridge*, 424 U.S. at 333, 348–49. It would be unfair to deprive the Zohar Funds of their property interests based on the "finding" on that issue in the Initial Decision because they never had an opportunity to present their case in that proceeding. And it does not appear from the Initial Decision that the SEC attempted to put on any evidence to rebut Tilton's equity ownership argument (likely because doing so would have been pointless).

I am satisfied that the Initial Decision does not have issue preclusive effect with respect to the equity ownership issue. That issue, instead, must be and has been decided in accordance with the evidence presented in these proceedings.

E. The Written Consents are Valid and Effective

Upon concluding that the Proxies are invalid and neither Tilton nor the entities she controls may vote the shares of the Portfolio Companies as beneficial owners of those shares, I must conclude that the Zohar Funds' Consents are valid and effective. The Defendants have not advanced any argument that the Consents are facially or otherwise invalid under the DGCL. The Zohar Funds had the authority to vote the disputed shares, and they properly did so through AMZM.[350]

III. CONCLUSION

For the foregoing reasons, declaratory judgments shall issue as follows: (1) the Proxies are invalid and ineffective; (2) the Zohar Funds are the beneficial owners of the disputed Portfolio Companies' shares; (3) the Zohar Funds' Consents are valid; and (4) the directors elected by AMZM on behalf of the Zohar Funds, as reflected in the Consents, are the rightful directors of the Portfolio Companies. The Zohar Funds shall submit a conforming final order and judgment within ten (10) days, upon notice to the Defendants.

[350] JX 812 (AMZM-Zohar II CMA) § 2.2(c); JX 813 (AMZM-Zohar III CMA) § 2.2(c).

APPENDIX

Structure of Tilton-Controlled Entities